Supreme Court, U.S.
FILED

(1)

No. 98-981065 DEC 2 8 1998

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1998

INDIANAPOLIS POWER & LIGHT COMPANY,

Petitioner,

vs.

PENNSYLVANIA PUBLIC UTILITY COMMISSION and PECO ENERGY COMPANY, *et al.*,

Respondents.

On Petition for Writ of Certiorari
to the Commonwealth Court of Pennsylvania

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Whether the "stranded cost" provisions of Pennsylvania's Electricity Generation Customer Choice and Competition Act, 66 PA. CONS. STAT. §§ 2801 *et seq.*, violate the Commerce Clause of the United States Constitution in requiring the State's retail electric customers, including those who buy electricity generated by an out-of-state producer, to pay a surcharge to subsidize the competing, formerly monopoly Pennsylvania utility for its uneconomic costs of producing electricity.

RULE 14(b) LISTS

1. The parties to the proceeding before the Commonwealth Court of Pennsylvania were (a) Indianapolis Power & Light Company (as petitioner); (b) the Pennsylvania Public Utility Commission (as respondent); and (c) PECO Energy Company; Metropolitan Edison Co.; Office of Consumer Advocate; PA Electric Company, trading as GPU Energy; Pennsylvania Power and Light Company; and Philadelphia Area Industrial Energy Users Group (as intervenors).

2. Indianapolis Power & Light Company's (a) parent corporation is IPALCO Enterprises, Inc., and (b) only non-wholly owned subsidiary is Tecumseh Coal Corporation.

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Indianapolis Power & Light Company ("IPL") respectfully petitions for a writ of certiorari to review the judgment of the Commonwealth Court of Pennsylvania in this case.

OPINIONS BELOW

The opinion of the Commonwealth Court, set forth in the Appendix ("App.") at 1a-37a, is reported at 711 A.2d 1071. The underlying Opinion and Qualified Rate Order ("Order") of the Pennsylvania Public Utility Commission (App. 39a-144a) is reported at 177 Pub. Util. Rep. 4th 417.

STATEMENT OF JURISDICTION

The judgment of the Commonwealth Court was entered on May 7, 1998. App. 38a. IPL timely filed with the Supreme Court of Pennsylvania on June 4, 1998 a Petition for Allowance of Appeal pursuant to PA. R. APP. P. 1112, which was denied by order dated September 29, 1998 and filed on October 1, 1998 (App. 145a). The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

CONSTITUTIONAL PROVISION AND STATUTE INVOLVED

The Commerce Clause, U.S. CONST. art. I, § 8, cl. 3, provides:

> The Congress shall have Power . . . To regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes.

This case also involves Pennsylvania's Electricity Generation Customer Choice and Competition Act, 66 PA. CONS. STAT. §§ 2801 to -12 ("Electricity Generation Act" or "Act"), the text of which is set forth at App. 146a-231a.

STATEMENT OF THE CASE

A. Pennsylvania's Electricity Generation Act.

The context of Pennsylvania's Electricity Generation Act is rapidly emerging competitive interstate markets for a product formerly viewed as a "natural monopoly" — retail electricity. Pennsylvania is one of several States that, in various ways, have already responded to these new markets. The Pennsylvania response includes the challenged provisions

of the Act, which require the State's retail electric customers, including those who buy electricity generated by an out-of-state producer, to pay a surcharge to subsidize the competing, formerly monopoly Pennsylvania utility for its uneconomic costs of producing electricity. The crux of this case is whether the Commerce Clause permits a State, when it shifts from monopoly regulation to competition, to discriminate in favor of its domestic participants in that competition. The answer has Nationwide import for State regulation in a dawning era of interstate retail electricity competition.

Historically, the electric industry had evolved into a structure characterized by two dominant features. First, retail customers have had to purchase electric service from a highly regulated public utility with a practical or legal monopoly in its geographic territory (or "service area"). Second, retail customers have had to buy from the monopoly utility three general categories of "functions" combined as a single product. One function, called "generation," is production of electricity (by fossil fuel or nuclear power plants or other means). The two other functions — "transmission" and "distribution" — involve moving electricity from the generator to the place of use.[1]

Technological and other changes, however, have sparked the potential for competition in retail electricity sales. Pennsylvania's Electricity Generation Act is one response, marking a major departure from the historical pattern by fundamentally restructuring that State's electric utility industry. The Act requires investor-owned utilities to "unbundle" — *i.e.*, to separate for purposes of sale to retail customers — the generation of electricity from its transmission and distribution. 66 PA. CONS. STAT. §§ 2802(14), 2804(3). With unbundling, transmission and distribution continue to be treated as a "natural monopoly," supplied solely by the incumbent Pennsylvania utility and regulated as a public utility service by the respondent Pennsylvania Public Utility Commission ("Commission"). *Id.* §§ 2802(16), 2804(10), 2807. But the electricity itself becomes a competitively provided commodity, with each retail customer having direct access to the competitive market. *Id.* §§ 2802(13)-

1. This Court recently surveyed (in a Commerce Clause context) the historical evolution of the gas utility industry into a regulated territorial monopoly structure, *General Motors Corp. v. Tracy*, 519 U.S. 278, 288-97 (1997), and noted that "essentially the same evolution [occurred] in the electric utility industry," *id.* at 289.

(14), 2804(2), 2806. To accomplish this, incumbent utilities must "provide open access over their transmission and distribution systems to allow competitive suppliers to generate and sell electricity directly to consumers in this Commonwealth." *Id.* § 2802(14).

A confluence of factors led Pennsylvania to shift from "natural monopoly" regulation (*id.* § 2802(1)) to a competitive market for generation. First, "advances in electric generation technology" and "Federal initiatives" in the wholesale electric market have made a competitive retail market possible. *Id.* § 2802(3). Second, "[r]ates for electricity in this Commonwealth are on average higher than the national average, and significant differences exist among the rates of Pennsylvania electric utilities." *Id.* § 2802(4). Third, "[c]ompetitive market forces are more effective than economic regulation in controlling the cost of generating electricity." *Id.* § 2802(5).

The State also decided, however, to protect high-cost Pennsylvania producers in the new competitive market. The in-state utilities are allowed to recover from all consumers so-called "[t]ransition or stranded costs," generally defined in the Act as generation costs the utility (1) could have recovered under traditional monopoly regulation, but (2) cannot recover at competitive market prices. *Id.* § 2803 (definition). The incumbent utility recovers these competitively unrecoverable generation costs through charges imposed on all consumers in its service area, regardless of the producer who generates their electricity. *Id.* §§ 2808(a), 2812(g) (definition of "[i]ntangible transition charges"). Thus, even consumers who buy electricity generated by an out-of-state producer must still pay this surcharge that subsidizes the competing, high-cost Pennsylvania producer for its own costs of generation — a product those consumers are not purchasing from that in-state utility.[2]

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2. The Act prescribes two mechanisms for Pennsylvania utilities to recover their competitively unrecoverable generation costs. One, called the "competitive transition charge," is recovered by the utility from all consumers in its service area ("certificated territory") over a period of years. 66 PA. CONS. STAT. § 2808. The second, called the "intangible transition charge," involves so-called "securitization" — under which the Commission makes the consumer charges irrevocable; the utility then issues bonds against the guarantee of those charges; and the charges, when collected, are used to repay bondholders. *Id.* § 2812. In the court below, the parties agreed there is no significant difference for Commerce Clause purposes between these alternative mechanisms.

B. Proceedings And Decisions Below.

Respondent PECO Energy Company ("PECO"), the incumbent Philadelphia-area electric utility, brought this case before the Pennsylvania Commission under § 2812 of the new Act. PECO sought an order requiring consumers in its service area to pay, and allowing PECO to securitize and receive, about $3.6 billion of an estimated $6.75 billion of generation costs — *i.e.*, its costs of producing electricity — that PECO would not be able to recover in the new competitive market for electricity. RR. 206a-207a.[3] PECO said it would seek to recover the remainder of these "stranded" generation costs in its separate restructuring case under § 2806 of the Act. RR. 324a. The bulk of PECO's stranded costs related to the uneconomic costs of its generating plants. RR. 209a.

IPL intervened before the Commission and presented evidence that, *inter alia*, requiring consumers to pay these stranded generation cost charges to PECO would disadvantage competing producers in the market for electric generation. *E.g.*, App. 259a-260a. IPL timely raised and argued, in its Brief of Intervenor, App. 232a-247a, and its Exceptions, RR. 230a, that imposing stranded cost charges on consumers, to benefit a high-cost Pennsylvania producer in competition with out-of-state producers of electricity, discriminates against interstate commerce and violates the Commerce Clause.[4]

The Commission's Order authorized PECO to recover and securitize $1.076 billion of stranded generation costs in this case, and postponed the remainder of PECO's request to the separate restructuring case. App. 76a, 122a-123a; *see* p. 6 n.6, *infra*. Citing Pennsylvania case law that constitutional determinations are not an administrative agency function, the Commission said it would not rule on constitutional challenges to the Act, App. 57a-58a, and never addressed IPL's Commerce Clause argument. Later in its Order, however, the Commission summarily rejected a Commerce Clause challenge by certain other intervenors called "the Environmentalists." App. 63a.

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3. "RR." refers to the Reproduced Record submitted to the Commonwealth Court pursuant to PA. R. APP. P. 2151 *et seq.*

4. PA. R. APP. P. 1551(a)(1) provides that questions involving the validity of a statute need not be raised before an agency as a prerequisite for judicial review. IPL nonetheless specifically raised the Commerce Clause issue before the Commission.

IPL petitioned the Commonwealth Court of Pennsylvania for review, again presenting the issue that the Act's stranded cost provisions, and the Commission's Order authorizing imposition of stranded cost charges for PECO, violate the Commerce Clause. The court rejected the Commerce Clause claim on the merits, giving many reasons.[5]

Most significantly, the Commonwealth Court held that the stranded cost provisions do "not implicate" or "involve" the Commerce Clause at all. App. 9a-10a & n.7, 16a, 23a, 27a. This is so, the court said, because the Act "as a whole" promotes interstate commerce, allowing out-of-state competitors into an area where all competition previously was excluded. App. 10a-16a. It further said the stranded cost provisions are "consistent" with "traditional" state regulation of retail electric rates, an area of utility regulation Congress "specifically apportioned" to the States. App. 10a, 16a-22a. The court also relied on the fact that the Federal Energy Regulatory Commission ("FERC") has granted stranded cost recovery in restructuring the gas and electric industries at the federal jurisdictional (*i.e.*, wholesale) level. App. 10a, 24a-25a.

The Commonwealth Court held in the alternative that the stranded cost provisions do not violate traditional Commerce Clause standards. App. 28a-33a. It said the Supreme Court's strict scrutiny test under the Commerce Clause did not apply, because the "true purpose" of the Act "as a whole" is not to discriminate against interstate commerce but rather to promote competition, and the stranded cost charges for high-cost Pennsylvania producers "have no discriminatory effect on interstate commerce because the recoveries are purely intrastate concerns and afford no unfair advantage to local utilities." App. 29a. The court stated that stranded cost charges are "levied only on Pennsylvania residents," are limited in "duration" and "amount," and are "restitution intended to place PECO where it would have been had regulation continued, rather than . . . subsidies intended to place PECO at an advantage." App. 13a-14a, 15a-16a, 21a. It further said that invalidating stranded cost recovery for PECO would give IPL a "competitive advantage." App. 23a.

The Commonwealth Court then held that stranded generation cost charges for in-state producers serve Pennsylvania's interests in

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5. The Commerce Clause issue was the primary (and, other than the contingent severability question, the only) issue IPL raised on appeal. *See* App. 248a-253a.

maintaining financially viable "transmission and distribution" utilities and assuring decommissioning of "nuclear power plants." App. 30a-33a. It said stranded cost charges would keep "electric generation capacity" and "energy companies" in Pennsylvania. App. 29a-30a n.16, 31a. It rejected as unreasonable the alternative of accomplishing these interests by conditioning stranded cost recovery on divestiture of the incumbent utility's generating business, saying this would "raise the issue of an unconstitutional taking" and "could [leave Pennsylvania] . . . with little or no local electric generation capacity." App. 29a-30a n.16.

IPL petitioned the Supreme Court of Pennsylvania for allowance of appeal, again raising the Commerce Clause issue. *See* App. 254a-258a. The Pennsylvania Supreme Court denied the petition, thus precluding any further review in the State's courts. App. 145a.[6]

REASONS FOR GRANTING THE WRIT

As in the airline and trucking industries some years ago, and like the telephone and gas utility industries today, technological change and abandonment or modification of traditional public utility regulation are making the electric industry increasingly competitive. Both the Federal Government and States throughout the Union are now taking or contemplating actions that will set the legal framework in which the burgeoning interstate markets for electricity will function. In addition to federal regulatory changes affecting the wholesale electricity market, at least 18 States have already taken or are actively considering statutory or regulatory steps (or both) to develop competitive markets for retail electricity sales.[7]

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6. In PECO's separate restructuring case under § 2806 of the Act, IPL and PECO stipulated that the record for the Commerce Clause issue would be the same as the record in this case; that IPL's appeal in the restructuring case would raise only that issue; and that disposition of the Commerce Clause issue in this case will control its resolution in the restructuring case. On May 14, 1998, the Commission entered its final order in the restructuring case, granting PECO total stranded cost recovery of $5.26 billion. IPL timely filed in the Commonwealth Court a petition for review of that order. Based on the parties' stipulation, the Commonwealth Court has stayed IPL's appeal in the restructuring case pending final resolution of this case.

7. *See* Basheda, *et al.*, *The FERC, Stranded Cost Recovery, and Municipalization*, 19 ENERGY L.J. 351, 378-82 (1998) (chart summarizing pending

(Cont'd)

Pennsylvania's Electricity Generation Act, and the decision below that its challenged provisions are exempt from Commerce Clause scrutiny, are at the cutting edge of this development. This case presents the issue whether the States, when they respond to economic and technological change by undertaking deregulation and permitting competitive markets where none previously existed, may do so free of the constitutional strictures the Commerce Clause otherwise places on state regulation of interstate commerce. Pennsylvania's appellate court said "yes." That constitutional question and answer, which will determine if individual States may favor their own domestic participants in interstate markets of soon-to-be Nationwide scope, merit the review and guidance of this Court.

I. The Pennsylvania Act's "Stranded Cost" Provisions Violate Established Commerce Clause Standards By Imposing A Surcharge That Subsidizes Pennsylvania Producers And Handicaps Their Out-Of-State Competitors — Actions That Invite "Economic Balkanization" And Retaliation By Other States In The Developing Interstate Markets For Retail Electricity Sales.

While the Commerce Clause is phrased as a grant of power to Congress, this Court has held for more than 150 years that it also constitutionally limits state economic regulation that impedes "the free flow of commerce across state lines . . . ." *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 206 (1994). In this case, Pennsylvania's scheme of mandated surcharges to subsidize its in-state utilities in competition with out-of-state electricity generators is the precise analogue, in the newly emerging interstate markets for retail electricity sales, of the Massachusetts scheme to subsidize in-state dairy farmers that this Court invalidated in *West Lynn Creamery*.

As the court below correctly noted, the "paradigmatic example" of a state law that violates the Commerce Clause "'is the protective tariff

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(Cont'd)
or completed statutory and regulatory action by various States involving competitive interstate sales of retail electricity). The principal federal response at the wholesale level is FERC Order No. 888, *Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Service by Public Utilities; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, 61 Fed. Reg. 21,540 (1996), and related orders (collectively, "Order 888"), which requires "unbundling" by wholesale generation suppliers that are subject to FERC jurisdiction.

or customs duty, which taxes goods imported from other States, but does not tax similar products produced in State.'" App. 8a, quoting *West Lynn Creamery*, 512 U.S. at 193. Such a tariff "violates the principle of the unitary national market by handicapping out-of-state competitors, *thus artificially encouraging in-state production even when the same goods could be produced at lower cost in other States*." *West Lynn Creamery*, 512 U.S. at 193 (emphasis added).

The lower court was also correct that the Commerce Clause bars state laws that "attempt 'to reap some of the benefits of tariffs by other means.'" App. 8a, again quoting *West Lynn Creamery*, 512 U.S. at 193. Specifically, States may not use discriminatory laws to try "'to neutralize advantages belonging to the place of origin'" — including "the advantage possessed by *lower cost* out-of-state producers. . . ." *West Lynn Creamery*, 512 U.S. at 194 (emphasis added), quoting *Baldwin v. G.A.F. Seelig, Inc.*, 294 U.S. 511, 527 (1935). *See also e.g., Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 406 (1984) (State may not use discriminatory measures "in an attempt to 'induce business operations to be performed in the home State that could more efficiently be performed elsewhere'"), quoting *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 336 (1977).

The "stranded cost" provisions of the Pennsylvania Act violate this constitutional rule. The Act opens the retail electric generation market in Pennsylvania to competition. The stranded cost provisions, however, impose surcharges by which all customers must subsidize the generation and sale of electricity in that competitive market by high-cost Pennsylvania producers. Through the "competitive transition charge" and "intangible transition charge," these in-state producers receive huge sums of money they are unable to earn in competition with out-of-state electric generation producers. The in-state producers are allowed to keep ownership of their generating plants; to use those facilities to compete in an open generation market; and to cover their competitive losses through *charges for their own generation costs, which are imposed by state law on consumers who buy electricity generated by out-of-state producers.*

These state-mandated surcharges flatly discriminate in favor of high-cost Pennsylvania producers and handicap their lower-cost, out-of-state competitors. In economic substance, the Pennsylvania Act's "stranded cost" mechanisms to benefit in-state producers are indistinguishable from

the Massachusetts "premium payment" device to benefit in-state dairy farmers struck down in *West Lynn Creamery*. There, Massachusetts required in-state milk dealers to pay into a "Dairy Equalization Fund" a "premium payment" on all milk they sold in the State. While the "premium payments" were imposed regardless where the milk had been produced, the proceeds were given to in-state milk producers to enable them to compete with out-of-state producers. 512 U.S. at 190-91, 194. This Court analogized the "premium payments" to a tax. Though the "tax" was evenhanded in that it applied to all milk whether produced in-state or out-of-state, *see id.* at 194-96, the scheme was invalid because the "tax" proceeds were paid exclusively to the in-state farmers to subsidize their ability to compete — thus "neutralizing the advantage possessed by lower cost out-of-state producers," *id.* at 194. Hence, it was "clearly unconstitutional," since its "purpose and its undisputed effect [were] to enable higher cost Massachusetts dairy farmers to compete with lower cost dairy farmers in other States." *Id.*

Pennsylvania's "stranded cost" surcharges have the identical effect, for the identical purpose, in the retail electricity market. Though the surcharges are imposed on all consumers — regardless of which electricity generator they choose and whether that generator is an in-state or out-of-state producer — surcharge revenues are used exclusively to benefit high-cost Pennsylvania producers. As in *West Lynn Creamery*, the purpose and effect are "to enable higher cost [Pennsylvania producers] to compete with lower cost [producers] in other States," and "neutraliz[e] the advantage possessed by lower cost out-of-state producers . . . ." Under the established Commerce Clause standards applied in *West Lynn Creamery*, this is a "clearly unconstitutional" discrimination against interstate commerce.

Allowing the Pennsylvania court's erroneous contrary pronouncement to stand would threaten the core purposes of this Court's dormant Commerce Clause jurisprudence in rapidly developing interstate markets of enormous import. This will have impact on everyone who uses electricity — namely, every American consumer. The contours of these growing interstate markets for retail electricity are now being shaped by state legislatures and utility commissions across the Nation. The challenged provisions of the Pennsylvania Act posit that one feature of such interstate markets can be state-mandated surcharges to subsidize in-state electric generators to the detriment of out-of-state producers.

The Pennsylvania appellate court proclaims this is exempt from Commerce Clause strictures. If those statutory provisions and the reported appellate decision blessing them survive, they will be a landmark other States are sure to note and follow.

"Avoiding this sort of 'economic Balkanization,' and the retaliatory acts of other States that may follow, is one of the central purposes of [this Court's] negative Commerce Clause jurisprudence." *Camps Newfound/Owatonna, Inc. v. Town of Harrison*, 520 U.S. 564, 577 (1997), quoting *Hughes v. Oklahoma*, 441 U.S. 322, 325 (1979). This Court has therefore been vigilant in barring state action discriminating in favor of in-state competitors — even when, as in *C & A Carbone, Inc. v. Clarkstown*, 511 U.S. 383, 389, 391 (1994), a regulation favors but a single company in a local area and handicaps all other in-state (as well as all out-of-state) competitors.

Exercise of that vigilance is far more vital here, where the scope and impact of the discrimination are far broader than in cases such as *Camps Newfound/Owatonna* and *C & A Carbone*. A high-cost Pennsylvania producer receiving stranded cost surcharges may use that advantage in competing to sell electricity not only in its own service area, but also throughout both (a) the competitive Pennsylvania retail generation market, and (b) the market for retail electricity in every other State that has already abandoned monopoly provision of retail electricity for a competitive marketplace or later decides to do so. Such States will not be blind to the discriminatory advantages the Pennsylvania Act confers on high-cost Pennsylvania producers, nor deaf to the responsive entreaties of their own high-cost generators.

The result, if the Pennsylvania model is allowed to stand, will be new interstate markets characterized by a patchwork of competing and retaliatory surcharge and other discriminatory devices, each designed to give the adopting State's generators a leg-up on their out-of-state counterparts. Even the prospect of such an outcome has never been countenanced by this Court, whose negative Commerce Clause jurisprudence exists to prevent it.

II. The Need For Review Is Heightened By The Pennsylvania Court's Wrong And Unprecedented Reasoning That The Commerce Clause Does Not Even Apply.

The Commonwealth Court's primary ground for upholding the Pennsylvania Act's "stranded cost" provisions was its conclusion that the Commerce Clause does not apply at all to state regulation of retail electricity sales. The court gave "three reasons" for its view that the Commerce Clause is "not implicate[d]" here. App. 10a. Each "reason" conflicts, directly or in principle, with this Court's precedents. This contravention of established constitutional jurisprudence, in service of the state court's exempting a major area of interstate commerce from Commerce Clause strictures, highlights the need for this Court's review.

A. The Thesis That The Commerce Clause Is Not "Implicated" Or "Involved" When States Deregulate Economic Activity Conflicts With The Purpose Of The Clause And This Court's Precedents, Is Sweeping In Its Breadth, And Independently Warrants Review.

The Commonwealth Court's central rationale for holding that the Commerce Clause is "not implicate[d]" or "involve[d]" was that the "purpose" and "practical effect" of the Pennsylvania Act "as a whole" are not to discriminate against but rather to facilitate interstate commerce. The Act allows competition in the Pennsylvania market for retail electricity, a commodity previously provided only as a regulated monopoly service. In the eyes of the court below, since the net effect was more interstate commerce than before, the State was free of Commerce Clause restrictions in imposing conditions on that new competition. *See* App. 10a-16a.

This analysis jettisons the Commerce Clause whenever a State engages in economic deregulation (however discriminatory) if the effect of the State's action "as a whole" can be said to lead to "more" interstate commerce than before. Thus, in deregulating economic activity (or, for that matter, doing anything else whose net overall impact is "more" interstate trade) a State could impose any discriminatory restrictions it wished on out-of-state competitors — whether by placing import tariffs or quotas on their products, picking and choosing which out-of-state companies will be allowed to compete, or imposing any other protectionist device. The sweep of this thesis, and the straitjacket it places on this

Court's doctrine and precedents, independently warrant review. Under that thesis, for example, the tax scheme in *West Lynn Creamery* would have been upheld had only it been preceded by an evenhanded but more intrusive regulatory structure that yielded "less" interstate commerce than its discriminatory replacement.[8]

This by itself illustrates that the analysis below contravenes this Court's precedents and the core constitutional values of the Commerce Clause. This Court has twice expressly rejected arguments that discriminatory state laws were valid because their overall effect was to "promote" interstate commerce. *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 274-75 (1988); *Great Atl. & Pac. Tea Co. v. Cottrell*, 424 U.S. 366, 378-80 (1976). As stated in *Great Atl. & Pac. Tea*, permitting discriminatory state regulation on a theory that it "promotes trade between the States" would be "precisely calculated to open 'the door . . . to rivalries and reprisals that were meant to be adverted by subjecting commerce between the states to the power of the nation.'" 424 U.S. at 379, 380 (1976), quoting *Baldwin*, 294 U.S. at 522.[9]

In a related vein, the decision below suggests that, because Pennsylvania could have kept the retail generation market a regulated monopoly — thus precluding *any* interstate commerce — it was free to create a competitive market on any terms it wished, including terms that favor in-state utilities and handicap out-of-state participants. *See* App. 9a-10a n.7 ("statutes that were struck down by the Supreme Court involved the stifling of interstate commerce in then currently competitive markets. The [Pennsylvania] Act, read in whole, invites competition

8. Theoretically, the lower court's thesis here would pave the way to impose such a discriminatory tax scheme even now. All a State need do is (1) exercise its undoubted police power to impose a pervasive regulatory regime whose effects would include far less interstate commerce than a *laissez faire* approach, and then (2) "deregulate" the area while adding the discriminatory tax scheme to protect local producers in the new competitive era — which would "as a whole" unquestionably create "more" interstate commerce.

9. More generally, any analytic approach that excuses discrimination based on "net economic impact" ignores that "'the negative implications of the commerce clause derive principally from a *political* theory of union, not from an *economic* theory of free trade. The function of the clause is to ensure national solidarity . . . .'" *C & A Carbone*, 511 U.S. at 417-18 n.6 (Souter, J., dissenting) (emphasis original), quoting L. TRIBE, AMERICAN CONSTITUTIONAL LAW 417 (2d ed. 1988).

into an industry that has been historically limited to state-regulated monopolies, and as such, it is so distinct from Commerce Clause precedent that we must find that it does not involve the Commerce Clause.")

In addition to suffering the same flaws as any other "net economic impact" approach to Commerce Clause analysis, this sort of "greater-power-includes-the-lesser" reasoning has repeatedly been rejected by this Court. For example, the "commodity" involved in the interstate "market for corporate control" is state-created corporations, *CTS Corp. v. Dynamics Corp. of America*, 481 U.S. 69, 89, 90, 94 (1987) — which States are free not to create in the first place. But if States do create corporations under state law, the Commerce Clause requires "that residents and nonresidents have equal access to them." *Id.* at 94. Similarly, States have "undisputed power" to grant or to refuse tax exemptions; but they may not do so in ways that discriminate against interstate commerce. *West Lynn Creamery*, 512 U.S. at 201. *See also C & A Carbone*, 511 U.S. at 394 ("having elected to use the open market to earn revenues for its project, the town may not employ discriminatory regulation to give that project an advantage over rival businesses from out of State").[10]

The related notions that inform the decision below — that any state action opening-up an area formerly regulated as a monopoly or otherwise yielding a "net overall increase" in the amount of trade is exempt from Commerce Clause scrutiny — cannot be squared with this Court's precedents. Both notions are fraught with danger for the core constitutional purpose that informs those precedents and is served by the Clause — namely, non-discriminatory economic intercourse among States joined in a national political Union. Left uncorrected, the reasoning below will vitiate that purpose, inviting State-by-State discrimination not only

10. These and other cases — *e.g.*, *Bendix Autolite Corp. v. Midwesco Enter.*, 486 U.S. 888, 893 (1988); *Western Union Tel. Co. v. Kansas* ex rel. *Coleman*, 216 U.S. 1, 34-37 (1910) — are, directly or in effect, Commerce Clause applications of the doctrine of "unconstitutional conditions." Notwithstanding that a State has otherwise unfettered power whether to take a particular action or grant a particular benefit (and therefore may elect not to do so at all), it may not condition the action or benefit in ways that violate constitutional provisions. *E.g.*, *Board of County Comm'rs v. Umbehr*, 518 U.S. 668, 674 (1996) (First Amendment); *Dolan v. City of Tigard*, 512 U.S. 374, 385 (1994) (Fifth Amendment property rights).

in the important new field of interstate commerce at issue here (retail sales of electricity), but also in other new arenas of commercial activity that technological development and other fruits of human ingenuity may open to interstate commerce in an unpredictable future. Implications of such scope and potential import warrant this Court's attention.

B. The State Court's Theory That "Stranded Cost" Provisions Escape Commerce Clause Scrutiny Because They Fall Within "Traditional" Retail Rate Regulation, And That Congress Has "Apportioned" This Area Of Utility Regulation To The States, Contravenes And Misconstrues This Court's Precedents.

As its second reason for holding that the Commerce Clause is "not implicate[d]," the lower court said the stranded cost provisions are "consistent with traditional state regulation" of retail electric sales, and that Congress "appears to have apportioned to the states" this area of utility regulation. App. 10a, 16a-22a. This second rationale ignores or misconstrues important Commerce Clause precedents of this Court — including *General Motors Corp. v. Tracy*, 519 U.S. 278 (1997), the only such precedent involving utility deregulation — and opens a wide door for state discrimination against interstate commerce never contemplated or sanctioned by Congress.

At the outset, the analysis below fails to recognize the crucial distinction between (1) federal legislation that affirmatively *authorizes* the States to regulate in ways that would otherwise violate the dormant Commerce Clause; and (2) legislation that simply *preserves* existing state authority (as by making clear that a federal statute does not preempt state law). To be sure, Congress may (as the court below said) "empower states to act in a manner that absent its permission would violate the Commerce Clause." App. 6a-7a. But this Court has consistently required that congressional intent to exempt state regulation from Commerce Clause limits must be "expressly stated," *Sporhase v. Nebraska* ex rel. *Douglas*, 458 U.S. 941, 960 (1982), "unmistakably clear," *Maine v. Taylor*, 477 U.S. 131, 139 (1986), and "unambiguous," *Wyoming v. Oklahoma*, 502 U.S. 437, 458 (1992).

There is no such congressional authorization here. This Court has *twice* held that the Federal Power Act does *not* authorize electric utility regulation by States that would otherwise violate the dormant Commerce

Clause. *Wyoming v. Oklahoma*, 502 U.S. at 457-58; *New England Power Co. v. New Hampshire*, 455 U.S. 331, 341 (1982).[11]

Ignoring both the prerequisites for congressional "authorization" and this Court's holdings in *Wyoming v. Oklahoma* and *New England Power*, the court below apparently believed its reasoning is supported by *Tracy*. *See* App. 17a, 20a-21a. This is equally wrong, and improperly treats this Court's only Commerce Clause precedent involving utility deregulation as a blank check, in fact never drawn by this Court, for the States to discriminate as they please in this area.

Tracy involved Ohio's exemption from its sales and use taxes of natural gas sales by local distribution companies ("LDCs") — regulated public utilities providing monopoly service to most retail customers. 519 U.S. at 282. However, due to changes in the natural gas industry similar to those in the electric industry, some industrial customers could instead purchase "unbundled" gas from natural gas producers or independent marketers. *Id.* at 283-85. Because (1) LDCs were in-state companies, and (2) retail gas sales to industrial customers by non-LDC sellers did not receive the tax exemption, the exemption was claimed to discriminate against out-of-state non-LDC sellers and violate the Commerce Clause.

This Court disagreed, relying on circumstances in marked contrast to those presented here. The LDCs and non-LDCs in *Tracy* were *not* in competition for the bulk of the retail market; rather, the LDCs provided regulated, monopoly service to most customers. *Id.* at 297-302. While there was some competition between LDCs and non-LDCs for gas sales to industrial customers, Commerce Clause precedent dictated no clear answer to this "dual market" situation. *Tracy* found no Commerce Clause violation because (1) public utility regulation in the natural monopoly context had traditionally been upheld under the Commerce Clause, and

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11. In contrast, the Federal Power Act case on which the court below relies — *Connecticut Light & Power Co. v. FPC*, 324 U.S. 515 (1945), *see* App. 19a-20a — concerns only Congress's statutory division of regulatory authority between the States and the Federal Power Commission (now FERC), and *not* congressional authorization for States to engage in electric utility regulation free of dormant Commerce Clause limits. This Court has long forsaken the view that the line between "wholesale" and "retail" regulation demarks any Commerce Clause boundary. *See Arkansas Elec. Coop. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 377-80, 389-93 (1983); *Tracy*, 519 U.S. at 291 n.8.

(2) Commerce Clause principles applicable to competitive markets might "imperil the delivery by regulated LDCs of bundled gas to the noncompetitive captive market." *Id.* at 303-09.[12]

Tracy lends no support to the analysis below. Here, there are no "dual markets." Under the Pennsylvania Act, *all* electric generation is "unbundled" and *all* retail customers are supplied by the competitive market. 66 PA. CONS. STAT. §§ 2802(13)-(14), 2804(2), 2806(a)-(b) [App. 149a, 160a, 194a-197a]. Here, there is no state interest in protecting "captive" customers for whom a regulated monopoly is the only source of supply (the core rationale for *Tracy*'s result). Pennsylvania's legislature has determined that consumer interests in electric generation are best served by competition, not monopoly regulation. Under its Act, there are no "captive" retail electricity customers; "all customers of electric distribution companies in this Commonwealth shall have the opportunity to purchase electricity from their choice of electric generation suppliers." *Id.* § 2806(a).[13]

Ignoring the "dual market" and "captive customer" circumstances relied on by this Court, the court below effectively viewed *Tracy* as prospective absolution for discriminatory transgressions by the States in regulating retail utility sales. This Court was explicit that "state regulation of retail sales is *not*, as a constitutional matter, immune from our ordinary Commerce Clause jurisprudence. . . ." 519 U.S. 291 n.8 (emphasis added). The court below, however, describes this footnote as "discussing how *all* state regulation is not immune from Commerce Clause jurisprudence." App. 21a (emphasis added). It then describes Justice Scalia's dissenting observation in *Camps Newfound/Owatonna*, 520 U.S.

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12. As the Court had previously held in rejecting a Commerce Clause challenge to state gas utility regulation in the natural monopoly context, allowing competition for industrial customers in that context would skim "'the cream of the volume business'" and "adversely [affect] . . . [the LDCs'] over-all costs of service and its rates to customers whose only source of supply is [the LDC]." *Id.* at 305 (brackets added by Court), quoting *Panhandle Eastern Pipe Line Co. v. Michigan Pub. Serv. Comm'n*, 341 U.S. 329, 334 (1951).

13. Furthermore, even as to the limited competition in *Tracy* for industrial customers, LDCs supplied gas pursuant to regulated tariffs and there was no *price* competition. Even in the largely "captive customer" context, *Tracy* expressly stated it was *not* deciding any Commerce Clause issue where a utility's competitive sales were *not* "price-regulated" by the State. 519 U.S. at 296-97 n.11.

at 607, as "proffering that *Tracy* creates a 'public utilities' exception to the dormant Commerce Clause." App. 21a. From this emerges the lower court's conclusion: "Had Pennsylvania continued its previous regulatory scheme, it would have undoubtedly permitted the recovery of stranded-costs through regulated rates, and there is no justification for disallowing these recoveries in a new competitive market." App. 21a.

This mangles the majority opinion Justice Scalia joined in *Tracy*, as well as his *Camps Newfound/Owatonna* dissent. The point of the *Tracy* footnote is not that "*all* state regulation is not immune" from the dormant Commerce Clause (with the implicit suggestion that "*some* is"). Rather, it is that state regulation of retail utility sales is specifically *not* categorically exempt — absent which there would have been no need for the Court's careful analysis of why regulation in the "dual market" context of *Tracy* did not run afoul of the Clause. Further, even were a majority of the Court to embrace the view that *Tracy* "effectively creates what might be called a 'public utilities' exception to the negative Commerce Clause," *Camps Newfound/Owatonna*, 520 U.S. at 607 (Scalia, J., dissenting), the critical word (penned by one who attends diction) is "public." If *Tracy* yields any Commerce Clause "exception," it is precisely in the area of traditional regulation of monopoly or (as in *Tracy*'s "dual market" context) quasi-monopoly "public" utilities.[14]

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14. This is illuminated by the fuller discussion of *Tracy* earlier in Justice Scalia's *Camps Newfound/Owatonna* dissent:

> Such [domestic public utility] entities, we conclude, are not "similarly situated" to other fuel distributors; their insulation from out-of-state competition does not violate the negative Commerce Clause because it "serves important interests in health and safety." The Court in *Tracy* paints a compelling image of people shivering in their homes in the dead of winter without the assured service that competition-sheltered public utilities provide.

520 U.S. at 602 (citations omitted). Here, the domestic utilities granted discriminatory advantage by the Pennsylvania Act are *not*, with respect to electric generation, monopoly or quasi-monopoly public entities with obligations evoking "interests in health and safety" that could "exempt" such discrimination from Commerce Clause scrutiny. *See also infra* at p. 27 (describing separate provisions of the Pennsylvania Act that directly serve "interests" of the sort noted by Justice Scalia in describing the *Tracy* holding). *Cf. Nynex Corp. v. Discon, Inc.*, __ U.S. __, 1998 U.S. LEXIS 8080 [*1], [*16] (Dec. 14, 1998) (recognizing difference for purposes of antitrust laws of "competitive market" situations *versus* "exercise of market power that is lawfully in the hands of a [regulated] monopolist").

Hence, the lower court's conclusion from its misreading both of *Tracy* and of Justice Scalia's later comments in *Camps Newfound/Owatonna* is 180 degrees off-the-mark. "Had Pennsylvania continued its previous [monopoly] regulatory scheme," it might indeed "have permitted the recovery of stranded costs through regulated rates" for that monopoly service and not involving out-of-state competition. But this does not mean — and *Tracy* (even as later described by Justice Scalia) does not suggest — that a State therefore has a free hand to permit such "recovery" *via* discriminatory surcharges that favor its domestic producers and handicap out-of-state competitors "in a new competitive market" for retail electricity *not* served by monopoly public utilities. This mangling of the Court's only precedent involving utility deregulation — whose Commerce Clause analysis in fact turned on the dispositive extent to which monopoly deregulation had *not* occurred in that case — independently justifies review.

This is all the more so given this Court's proper reluctance to exempt state regulation of entire fields of interstate economic activity from Commerce Clause scrutiny. *See Camps Newfound/Owatonna*, 520 U.S. at 572-75 (rejecting theories seeking to make dormant Commerce Clause "inapplicable" to particular activities); *City of Philadelphia v. New Jersey*, 437 U.S. 617, 621-22 (1978) (rebuffing any "two-tiered definition of commerce," and holding that "[a]ll objects of interstate trade merit Commerce Clause protection"). The "object of interstate trade" here is retail sales of electricity. No congressional authorization exempts that activity from Commerce Clause protection against state discrimination. Nor is any such exemption conferred by *Tracy*. The Pennsylvania court's contrary pronouncements pave a discriminatory path that neither Congress nor this Court has opened.

C. No Statute Or Precedent Supports The State Court's Apparent Theory That FERC's Allowance Of Stranded Cost Recovery At The Federal Level Renders Discriminatory Stranded Cost Regulation By The States Exempt From The Commerce Clause.

The Commonwealth Court's third reason for finding the Commerce Clause "not implicate[d]" is that "other forums" have allowed stranded cost recovery. App. 10a, 22a-23a. In particular, it noted that FERC has granted stranded cost recovery in restructuring the gas and electric utility industries at the wholesale level. App. 24a-25a.

The obvious flaw in this reasoning is that FERC is a *federal* administrative agency. As such, it obviously is not subject to the restraints on state regulation of interstate commerce imposed by the dormant Commerce Clause. Unlike regulation by individual States, regulation of interstate commerce by the Federal Government at least makes possible uniform rules for all competitors — which is what the Framers had in mind in giving Congress the commerce power. *See, e.g., H.P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525, 533-34 (1949).

Equally wrong is any implication by the lower court that FERC action at the wholesale level somehow authorizes States to act at the retail level free of the limitations imposed by the dormant Commerce Clause.[15] First, no statute provides and no case holds that an *administrative agency* may authorize States to violate the dormant Commerce Clause. Rather, the "rule requir[es] a clear expression of approval *by Congress*. . . ." *South-Central Timber Dev., Inc. v. Wunnicke*, 467 U.S. 82, 92 (1984) ("The fact that the state policy in this case appears to be *consistent* with federal policy . . . is an *insufficient* indicium of congressional intent") (emphases added). Second, FERC's Order 888 could not — and does not purport to — *authorize* States to impose retail stranded cost recovery. FERC has *no jurisdiction* over retail electricity sales. *See* 16 U.S.C. § 824(b)(1) (limiting FERC's jurisdiction to wholesale power transactions and transmission in interstate commerce).

On a related front, this and other parts of the lower court's opinion suggest that stranded cost recovery does not "implicate" the Commerce Clause because the incumbent Pennsylvania producer's uneconomic generation costs become unrecoverable as a result of a change in regulation — specifically, the Act's opening of the retail generation market to competition. *See* App. 14a, 15a-16a, 23a, 25a-26a. This, too, conflicts with Commerce Clause precedent applying this Court's standards. In *Alliance for Clean Coal v. Miller*, 44 F.3d 591 (7th Cir. 1995), a case similar to this one in several respects, federal Clean Air Act amendments made it less economic for electric utilities to burn high-sulfur Illinois coal in generating electricity. In response, Illinois enacted a statute that *inter alia* encouraged utilities to install scrubbers (allowing air quality

15. The Pennsylvania Commission so argued, emphasizing the portion of FERC's Order 888 restructuring the wholesale electric industry that "encouraged" States to provide stranded cost recovery if they provide for retail unbundling and competition. Definitive Form Brief for Respondent Commission at 13-14.

standards to be met using high-sulfur coal), and provided that the Illinois commission would include the cost of the scrubbers in the utilities' rate bases (thus passing the cost on to electric customers). 44 F.3d at 593-94. Holding the statute invalid under *West Lynn Creamery*, the Seventh Circuit explained:

> Because the Illinois Coal Act, like the milk-pricing order in *West Lynn*, has the same effect as a "tariff or customs duty — neutralizing the advantage possessed by lower cost out of state producers" [of low-sulfur coal], it too is repugnant to the Commerce Clause and the principle of a unitary national economy which that clause was intended to establish.

Id. at 595.

As *Miller* illustrates, it makes no difference for Commerce Clause purposes whether the competitive "disadvantage" of in-state companies was in some sense "caused" by regulation — or by a change in regulation. The competitive disadvantage of in-state coal producers in *Miller* was caused by amendments to the Clear Air Act; but that did not justify a discriminatory state statute seeking to "re-level the playing field" *vis-a-vis* out-of-state producers. *See* 44 F.3d at 593, 595-96. Similarly, this Court has held that protectionist measures may not be used to offset advantages of out-of-state competitors that were created by regulation in their home States. *New Energy*, 486 U.S. at 278; *Hunt v. Washington State Apple Adver. Comm'n*, 432 U.S. 333, 336-37, 351-52 (1977). A State will almost always be able to point to one aspect or another of the legal framework in which interstate commerce occurs that "disadvantages" its domestic competitors. Were this to justify a discriminatory response, the dormant Commerce Clause's protection of non-discriminatory trade among States joined in national political Union would all but disappear.

III. The State Court's Alternative Theories That There Is No Discrimination Against Interstate Commerce, And That Various "State Interests" Justify The Act's Stranded Cost Provisions, Directly Contravene This Court's Precedents.

A. The Stranded Cost Provisions Subsidizing In-State Producers Unquestionably Discriminate Against Interstate Commerce.

After its extensive analysis that the Commerce Clause does not apply at all, the State court alternatively held that the stranded cost provisions do not violate traditional Commerce Clause standards. App. 28a-33a. However, it declined to apply this Court's strict scrutiny Commerce Clause test for state laws that discriminate against interstate commerce.[16]

The lower court refused to do so because — based on its previous analysis — it found the "Act *as a whole* does not discriminate in purpose or effect." App. 29a (emphasis added). This just repeats the erroneous theory that the Commerce Clause does not apply to state laws deregulating economic activity or otherwise yielding a "net overall increase" in the amount of trade.

Also based on its prior analysis, the Pennsylvania court said that "the stranded cost recoveries have no discriminatory effect on interstate commerce because the recoveries are purely intrastate concerns and afford no unfair advantage to local utilities." App. 29a. On these points, the court had previously said that stranded cost recoveries for Pennsylvania utilities are "limit[ed]" as to both "amount" and the "time period" over which they are recovered; "are paid strictly by the citizens of the Commonwealth of Pennsylvania"; and are "restitution intended to place PECO where it would have been had regulation continued," rather than "subsidies intended to place PECO at an advantage." App. 13a-14a, 15a.

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16. As the lower court acknowledged, a state law that discriminates against interstate commerce "is 'per se invalid, save in a narrow class of cases in which the [state] can demonstrate, under rigorous scrutiny, that it has no other means to advance a legitimate local interest.'" App. 28a, quoting *C & A Carbone*, 511 U.S. at 392. Later, the court in essence acknowledged that the challenged provisions could not survive this constitutional standard. *See* App. 34a ("it is . . . safe to assume that we would be required to strike down the stranded cost provision[s] as unconstitutional" if those "provisions are purposely and/or effectively discriminatory").

All these rationales for saying that the stranded cost provisions do not discriminate against interstate commerce directly conflict with this Court's precedents. Under the Commerce Clause, "'discrimination' simply means differential treatment of in-state and out-of-state economic interests that benefits the former and burdens the latter." *Oregon Waste Sys., Inc. v. Department of Envtl. Quality*, 511 U.S. 93, 99 (1994). *See also West Lynn Creamery*, 512 U.S. at 202 ("imposition of a differential burden on any part of the stream of commerce — from wholesaler to retailer to consumer — is invalid, because a burden placed at any point will result in a disadvantage to the out-of-state producer"); *Camps Newfound/Owatonna*, 520 U.S. at 580 (same). Moreover, "it is irrelevant to the Commerce Clause inquiry that the motivation of the legislature was the desire to aid the [in-state producers] rather than to harm out-of-state producers." *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 273 (1984).

Here, "differential treatment" is evident on the face of the Act. Only Pennsylvania producers get to recover generation costs above and beyond those recoverable at the competitive market price for electricity. No matter from whom they buy their electric generation, all consumers must pay surcharges for the in-state producer's uneconomic generation costs. As shown, this is substantively identical to the regulation invalidated in *West Lynn Creamery*, where the premium payments had to be made on all milk sold, but then were remitted solely to the in-state producers. The effect here is to enhance the ability of higher-cost in-state power generators — incumbent Pennsylvania producers — to compete with lower-cost generators in the new competitive interstate market. This cannot credibly be denied.

The strict scrutiny Commerce Clause test applies if either the "purpose" or the "effect" of a state regulation is to discriminate against interstate commerce. *Bacchus Imports*, 468 U.S. at 270. Here, there is no doubt that the purpose as well as effect of the stranded cost provisions is to protect high-cost Pennsylvania producers in competing with lower-cost competitors. Among other things, the Act states on its face that "[r]ates for electricity in this Commonwealth are on average higher than the national average," 66 PA. CONS. STAT. § 2802(4). The very definition of "stranded costs" of Pennsylvania generators is their generating costs "which may not be recoverable in a competitive electric generation market. . . ." *Id.* § 2803. Indeed, the Commission — whose earlier report was the foundation of the Act, App. 25a-26a — emphasized to

both the Commonwealth Court and the Pennsylvania Supreme Court that the purpose of the stranded cost provisions is to "level[ ] the playing field" so that high-cost Pennsylvania generators "can compete in an open market for generation." Definitive Form Brief for Respondent Commission at 15; Commission's Brief in Opposition to Petition for Allowance of Appeal at 18.

The lower court's repeated refrain that there is no discrimination against interstate commerce because stranded cost charges are paid only "by the citizens of the Commonwealth" (App. 15a; *see also* App. 21a, 22a, 29a) also directly contravenes this Court's precedents. The identical argument was made in *West Lynn Creamery — i.e.*, that there was no economic "protectionism" because the burden of the premium payments fell on "*only* in-state consumers. . . ." 512 U.S. at 203 (emphasis original). This Court said:

> The idea that a discriminatory tax does not interfere with interstate commerce "merely because the burden of the tax was borne by consumers" in the taxing State was thoroughly repudiated in *Bacchus Imports, Ltd v. Dias*, 468 U.S. at 272.

512 U.S. at 203. As this Court noted, the burden of a tariff — the "paradigmatic Commerce Clause violation" — also falls on in-state consumers. This Court reiterated that such discriminatory measures *also* benefit in-state producers to the detriment of out-of-state producers, and that, because they "discriminate against out-of-state products, they are unconstitutional." *Id.*[17]

The Pennsylvania court's theory that there is no discrimination against interstate commerce because stranded cost charges are "limited"

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17. The lower court also frequently says the stranded cost charges are paid by Pennsylvania consumers "in relation to transmission and distribution networks" in Pennsylvania. *E.g.*, App 22a. But it is undisputed — indeed, established by the Act's very definition of "[t]ransition or stranded costs" — that such charges exclusively involve the incumbent Pennsylvania utilities' "*generation-related* costs. . . ." 66 PA. CONS. STAT. § 2803 (emphasis added). The "relation" to the "transmission and distribution network" is that payment of the competitively-unrecoverable generation charges is assured because the incumbent utility is made by law the monopoly supplier of distribution service to retail consumers. *Id.* § 2802(16). Thus, consumers have to employ PECO and other incumbent Pennsylvania utilities to *deliver* electricity to them, but they cannot do so without paying the charges for the incumbent's uneconomic *generation* costs.

in amount and duration likewise directly contravenes this Court's precedents. This Court has repeatedly held that the "extent" or "amount" of the discrimination is irrelevant — the issue is whether there is "differential" treatment, not the "degree" of the difference. *Oregon Waste Sys.*, 511 U.S. at 100 n.4. *Accord, e.g., Bacchus Imports*, 468 U.S. at 269. "[T]here is no '*de minimis*' defense'" for laws that discriminate against interstate commerce. *Camps Newfound/Owatonna*, 520 U.S. at 581 n.15, quoting *Fulton Corp. v. Faulkner*, 516 U.S. 325, 333 n.3 (1996).

Furthermore, the impact of the discrimination here is not "*de minimis*" by any standard. PECO is awarded more than a *billion dollars* just by the instant Commission Order. The Commission found that allowing PECO simply to have the use of a few days "*float*" on that money would give it an advantage over competitors. App. 111a (emphasis added). Such "float income" and the corresponding effect on competition are minuscule compared to the massive subsidy payments PECO receives from the stranded cost recovery itself.

B. Pennsylvania Has Reasonable And Less Discriminatory Means To Accomplish Any Legitimate State Interests.

The court below characterized stranded cost charges as "restitution" and, in discussing the States' traditional power to regulate public utility rates in the monopoly context, called stranded cost charges a "continuation" of this authority to "ensure fair rates . . . and a reasonable return on investment for the utilities." App. 14a, 22a. Later, the court said that stranded cost charges ensure the financial ability of incumbent utilities to provide transmission and distribution (which remain monopoly services); to decommission nuclear plants; and to fulfill responsibilities "to serve low-income segments of Pennsylvania's population" and "as the provider of last resort to bridge the gap when out-of-state suppliers do not have enough electricity to service Pennsylvania consumers." App. 31a-33a.

All these rationalizations suffer the same core defect. A State may discriminate against interstate commerce only where "it has *no other means* to advance a legitimate local interest" — an issue on which the party defending the discrimination bears the burden of proof. *C & A Carbone*, 511 U.S. at 392 (emphasis added). *Accord, e.g., Camps Newfound/Owatonna*, 520 U.S. at 581-82; *Oregon Waste Sys.*, 511 U.S. at 100-01; *New Energy*, 486 U.S. at 278. Here, Pennsylvania has less

discriminatory means to achieve any conceivably legitimate state interest served by stranded cost recovery. All it need do is require in-state utilities who receive stranded cost subsidies to divest electric generation assets and refrain from the generation business.

Under divestiture, electric utilities may recover stranded costs, but must sell or spin off generation assets to unaffiliated entities. This eliminates the discriminatory and anti-competitive impact of stranded cost charges, which incumbents could otherwise use both to discourage entry by out-of-state (and other) competitors into the generation market, and to compete with a government-mandated advantage against those who do enter. In this case, for example (as IPL witness Brehm testified), conditioning stranded cost recovery on divestiture would

> establish a *real* current market price for PECO's assets while simultaneously avoiding the anti-competitive effects of allowing PECO to both receive the massive stranded cost cash flows and simultaneously to compete in the power sale market.

RR. 267a-268a (emphasis original).[18]

Here, however, the lower court began by erroneously placing the burden on IPL to show "a reasonable alternative to the stranded-cost recoveries that would impact interstate commerce less." App. 29a. It then relegated divestiture to a footnote rife with constitutional error. First, it said that requiring divestiture would "raise the issue of an unconstitutional taking. . . ." App. 29a-30a n.16. This is untenable. The Constitution does not forbid "takings" *per se*, but rather taking of property *without just compensation*. *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304, 314-15 (1987). As in

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18. According to Basheda, *et al.*, *supra* n.7, 19 ENERGY L.J. at 378-80, States that do or plan to condition stranded cost recovery on full or substantial divestiture of generation assets include Arizona, Connecticut, Maine, Massachusetts and New Hampshire. New England Electric System, a holding company with electric utilities in Massachusetts, Rhode Island and New Hampshire, agreed to divest its generating facilities in return for stranded cost recovery, and that divestiture is already occurring. *See NEES Agrees To Sell Generating Assets In Return For Stranded Cost Recovery*, Electric Utility Week (Oct. 7, 1996) at 1; *PG&E Unit To Pay $1.6 Billion For NEES Generating Assets*, The Energy Daily (Aug. 6, 1997) at 1.

any divestiture, investors would receive market value compensation — whether through shares of the spun-off company, or payment to the divesting utility by the purchaser of the generation assets. Further — and beyond any constitutionally required compensation — through their continuing ownership of that divesting utility such investors would also receive the benefit of that utility's stranded cost recovery.[19]

The lower court then dismissed divestiture as potentially leaving Pennsylvania "with little or no local electric generation capacity." App. 30a n.16. This classic rationale for discriminatory state action could not be more wrong. It is *not* a legitimate state purpose to discriminate against interstate commerce so as to keep production (or other economic activity) within the State's borders. This Court has repeatedly so held. *E.g.*, *West Lynn Creamery*, 512 U.S. at 194-95, 204-06; *Bacchus Imports*, 468 U.S. at 271-73; *see also* App. 9a & cases cited.[20]

These portions of the decision below are plagued by other significant problems as well. Maintaining financial viability of transmission and distribution utilities, and ensuring nuclear decommissioning, are unquestionably legitimate state interests; but stranded cost recovery under the Act *is not limited to amounts — if any — necessary to achieve these objectives*. The same is true of the alleged interests in "Pennsylvania

19. Nor are there other constitutional problems with divestiture. This Court has easily upheld state-compelled divestiture in a Commerce Clause case, stating that (1) "divesture is by no means a novel method of economic regulation, and is found in both federal and state statutes," and (2) "courts have had little difficulty sustaining such statutes against a substantive due process attack." *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 125 n.13 (1978).

20. The lower court's view that divestiture would leave Pennsylvania without local generation capacity is also factually groundless. Divestiture involves spin-off of generation businesses into independent companies and/or sales of generating assets. There is no reason why spun-off companies could not remain Pennsylvania companies, or why other Pennsylvania companies would not be among those bidding on generation facilities put up for sale. In any event, purchased generation assets in Pennsylvania would remain in Pennsylvania. The difference is that the new owners of those facilities would not be subsidized in their competitive generation businesses with huge sums of money collected from charges imposed by law on all consumers. Furthermore, the Pennsylvania Act expressly authorizes the Commission to allow divestiture *if* the incumbent in-state utility wants it; the Act just forbids the Commission from *requiring* it over the incumbent utility's objection. 66 PA. CONS. STAT. § 2804(5) [App. 166a-167a].

utilities . . . serv[ing] as the supplier of last resort to bridge the gap when out-of-state suppliers do not have enough electricity to service Pennsylvania customers," and "serv[ing] low-income segments of Pennsylvania's population," App. 31a- 32a, citing 66 PA. CONS. STAT. § 2802(10), (16).

Furthermore, as justifications for the stranded cost provisions, these last "state interests" are makeweights. Under the Act, the incumbent Pennsylvania utilities receive amounts necessary to provide service to low-income persons ("universal service"), and also for other social objectives such as conservation programs, through *a different and additional charge* imposed on all consumers. *Id.* §§ 2804(8)-(9), 2806(e) [App. 167a-168a, 177a-178a]. These matters have nothing to do with recovery of stranded costs for uneconomic generation assets. *See id.* As to "provider of last resort" responsibilities, the Act states on its face that the Commission may choose a supplier *other than* the incumbent Pennsylvania utility to perform this function. *Id.* §§ 2802(16), 2807(e)(3) [App. 150a, 186a]. Nor is there any requirement that the "provider of last resort" — whether the incumbent utility or a competitive supplier chosen by the Commission — must be a *generator* of electric power. To the contrary, the Act states on its face that this provider may "*acquire*" the necessary electric power (and do so "at prevailing market prices"). *Id.* § 2807(e)(2)-(3) [App. 186a] (emphasis added).

Finally, this sort of justification for discriminating against interstate commerce — *i.e.*, keeping in-state companies in business so they could supply if there were a shortage — has been repeatedly rejected by this Court. So, too has the further contention, implicit in the lower court's theory, that the State could require that competitive commodities produced in-state be kept for in-state consumption in a time of shortage. *E.g., H.P. Hood & Sons*, 336 U.S. at 535-39 (collecting cases); *Wyoming v. Oklahoma*, 502 U.S. at 456.

C. Pennsylvania May Not Discriminate To "Offset Advantages" Out-Of-State Competitors Supposedly Receive From Regulation In Their Home States.

The Pennsylvania court also said that invalidating the stranded cost provisions would give IPL an improper "competitive advantage" over PECO, on the theory that IPL "would be able to continue recovering similar costs under Indiana's regulatory scheme." App. 23a & n.11.

This analysis flatly contravenes settled Commerce Clause doctrine. This Court has repeatedly held that a State may not try to offset advantages out-of-state competitors get from regulation in their home States by discriminating against them or their products. *New Energy*, 486 U.S. at 278 (invalidating discriminatory Ohio tax credit where out-of-state competitor received cash subsidy from its home State); *Sporhase*, 458 U.S. at 958 n.18; *Hunt*, 432 U.S. at 336-37, 351-52. Even if another State is unconstitutionally discriminating against interstate commerce, the remedy is a Commerce Clause lawsuit against that State; retaliatory discrimination is forbidden. *Great Atl. & Pac. Tea*, 424 U.S. at 379-80 ("to the extent, if any, that [another State] is unconstitutionally burdening the flow of [goods] in interstate commerce . . . the Commerce Clause itself creates the necessary reciprocity").[21]

CONCLUSION

The "stranded cost" provisions of Pennsylvania's Electricity Generation Act discriminate against interstate commerce for the purpose, and with the effect, of subsidizing high-cost Pennsylvania utilities in competition with out-of-state generators. A State at the forefront of a vital new field of interstate commerce has thereby unambiguously staked-out a discriminatory position. A State appellate court, in a reported decision, not only has endorsed that position, but also has held — invoking reasoning irreconcilably at odds with this Court's constitutional jurisprudence — that the Commerce Clause does not even apply to this or other actions the States may take in this area of commerce. If the Pennsylvania model stands, the emerging interstate markets for retail electricity will be pockmarked from one State to the next with retaliatory discriminatory devices.

The budding prospect of that deleterious result can and should be nipped. The issue is of national import and is squarely framed. If addressed and correctly resolved now, all States will receive crucial guidance and vital new interstate markets will develop free of protectionist interstate economic warfare. If instead review is denied, States and affected private actors will take their cues, and that market will sprout a

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21. There is also no basis in the Record for the lower court's factual premise for its unconstitutional analysis. The undisputed Record is that IPL is an "efficient compan[y], which own[s] generation facilities with relatively low sunk costs and low operating costs. . . ." App. 260a.

hodgepodge of conflicting and protectionist features whose legal and economic impact will be difficult to unravel even were this Court later to take corrective steps. This is the case, and now is the time, for the Court to vindicate the core Commerce Clause principles at stake in this important new arena of interstate commerce.

The petition for certiorari should be granted.

Respectfully submitted,

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APPENDIX A — OPINION OF THE COMMONWEALTH COURT OF PENNSYLVANIA DATED AND FILED MAY 7, 1998

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

No. 1597 C.D. 1997
Argued: December 10, 1997

INDIANAPOLIS POWER & LIGHT COMPANY,

Petitioner

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,

Respondent

BEFORE: HONORABLE JAMES GARDNER COLINS, President Judge
HONORABLE BERNARD L. McGINLEY, Judge
HONORABLE DORIS A. SMITH, Judge
HONORABLE ROCHELLE S. FRIEDMAN, Judge
HONORABLE JAMES R. KELLEY, Judge
HONORABLE JIM FLAHERTY, Judge
HONORABLE BONNIE BRIGANCE LEADBETTER, Judge

OPINION BY
PRESIDENT JUDGE COLINS **FILED: May 7, 1998**

Before this Court is the appeal of Indianapolis Power & Light Company (IPL) from the decision of the Pennsylvania Public Utility Commission (PUC) granting PECO Energy's (PECO) application for the issuance of a qualified rate order to

recover stranded-costs pursuant to the Electricity Generation Customer Choice and Competition Act (Competition Act), 66 Pa. C.S. §§2801-12. This case presents an issue of first impression: whether the provisions of the Competition Act allowing the recovery of stranded-costs violate the Commerce Clause of the United States Constitution. We hold that they do not.[1]

I.

Historically, the functions of electric utilities fell into three broad categories: generation (creating electricity), transmission (moving electricity from the generating source to other areas of a utility's service area), and distribution (delivering electricity to consumers). These three functions were performed by a single, local utility in what was termed a "bundled" fashion. The local utility maintained a highly regulated monopoly over a designated service area, and consumers were charged rates set by a state regulatory agency for these "bundled" services.[2] This system of regulated monopolies providing "bundled" services developed because of the inability of a competition-driven market to serve the public welfare at the inception of the electric industry.[3]

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1. We may reverse a PUC decision where petitioner demonstrates a violation of constitutional rights, an error of law or lack of substantial evidence to support the PUC's findings of fact. *W.C. McQuaide, Inc. v. Pennsylvania Pub. Util. Comm'n*, 585 A.2d 1151, 1154 (Pa. Cmwlth. 1991).

2. "[The] retail sale of electricity is provided generally by public utilities under bundled rates regulated by the commission." 66 Pa. C.S. §2802(13).

3. *See General Motors Corp. v. Tracy*, __ U.S. __, __, 117 S. Ct. 811, 819 (1997) (discussing development of single, local franchises in

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Appendix A

Recognizing the modern day feasibility of a competition-driven electric generation market, Governor Ridge signed the Competition Act at the end of 1996. The Competition Act "unbundled" the three traditional functions of electric utilities in Pennsylvania in order to stimulate competition in the area of generation. Following a brief phase-in period, all Pennsylvania residents will be able to purchase their electricity from various in-state and out-of-state power companies licensed by the Commonwealth. At the same time, local utilities will remain responsible for transmitting and distributing electricity generated by themselves and all other licensed electric companies. Transmission and distribution will remain highly regulated.

Moving from a highly regulated industry to a market-driven industry will undoubtedly occasion some problems due to local

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gas industry and stating that electric industry suffered through "same evolution"). In discussing the development of the gas industry, which was analogous to the development of the electric industry, the Tracy-court notes that:

> It seemed virtually an economic necessity for States to provide a single, local franchise with a business opportunity free of competition from any source, within or without the State, so long as the creation of exclusive franchises under state law could be balanced by regulation and the imposition of obligations to the consuming public upon the franchised retailers.

__ U.S. at __, 117 S. Ct. at 820; *see also United Distribution Cos. v. FERC*, 88 F.3d 1005, 1122 n.4 (D.C. Cir. 1996) (discussing formation of natural monopolies in gas industry occasioned by high ratio of fixed costs to variable costs and how lack of competition allowed "a single firm [to] supply the service more cheaply than two firms could").

utilities' reliance on the continuation of regulated rates. Most notably, the former monopolies will be unable to recover substantial expenses and capital costs through market-determined prices. In anticipation of these transitional problems, the General Assembly included provisions in the Competition Act that allow the local electric utilities to recover their "stranded-costs." In essence, "stranded-costs" are the costs prudently incurred by the local utilities that will not be recoverable through market-determined prices, and that result from the utilities' reliance on the previous regulatory structure.[4]

The Act provides two basic mechanisms for utilities to recover stranded-costs. First, after PUC approval, utilities may

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4. The Commission found that the existing utility cost structure contained four categories of costs that could become stranded. They are:

1) Regulatory assets (deferred taxes, post-retirement employee benefits, etc.);

2) Non-utility generation contracts (which could include contracts to purchase electricity from qualifying facilities under the Public Utilities Regulatory Policies Act of 1978);

3) Utility generation assets (primarily nuclear power plants); and

4) Nuclear decommissioning costs.

Pennsylvania Public Utility Commission, Report and Recommendation to the Governor and General Assembly on Electric Competition (Competition Report), Docket No. 1-940032, p. 14 (July 3, 1996). *See also* 66 Pa C.S. §2803 (defining "transition or stranded-costs").

recover stranded-costs through a "competition transition charge"[5] that is paid by "every customer accessing the transmission or distribution network . . . to the electric distribution company in whose certificated territory that customer is located." 66 Pa. C.S. §2808(a). In other words, PUC will determine the amount of stranded-costs a utility is entitled to, and then this amount will be recouped over the course of several years by surcharging the residents of the area in which the utility transmits and delivers electricity (i.e., those living in the area where the utility previously maintained a monopoly over generation). Second, utilities may apply to PUC for a qualified rate order, whereby all or a portion of these future competition transition charges can be "securitized." 66 Pa. C.S. §2812. This process converts the utility's entitlement to receive future transition charges from its customers into a current, fully vested property right that may be pledged or sold as security for the issuance of transition bonds.

Pursuant to the Competition Act, PECO applied for a qualified rate order, requesting authorization to issue transition bonds in the amount of approximately $3.8 billion. After reviewing the evidence, PUC issued a qualified rate order

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5. Competitive transition charge is defined as:

> A nonbypassable charge applied to the bill of every customer accessing the transmission or distribution network which (charge) is designed to recover an electric utility's transition or stranded-costs as determined by the commission under Sections 2804 (relating to standards for restructuring of electric industry) and 2808 (relating to competitive transition charge).

66 Pa. C.S. §2803.

allowing PECO to securitize approximately $1.1 billion of its future competition transition charges. IPL, an Indiana electric company, then filed a petition for review with this Court in which it claims that permitting PECO to recover its stranded-costs violates the Commerce Clause of the United States Constitution.

II.

The Commerce Clause is an affirmative grant of power to Congress allowing it "[t]o regulate Commerce with foreign Nations, and among the several States." U.S. Const. art. 1, § 8, cl. 3. The effect that the Commerce Clause has on state powers is seen in the negative or dormant aspects of Congress's Commerce Clause power. "The negative or dormant implication of the Commerce Clause prohibits state taxation or regulation that discriminates against or unduly burdens interstate commerce and thereby 'impedes free private trade in the national market place.' " *General Motors Corp. v. Tracy*, __ U.S. __, __, 117 S. Ct. 811, 818 (1997) (quoting *Reeves, Inc. v. Stake*, 447 U.S. 429, 437 (1980)) (citations omitted). In sum, since Congress has plenary power to regulate commerce among the states, states are prohibited from passing laws that discriminate against interstate commerce.

Conversely, the Commerce Clause permits Congress to empower states with the authority to act in a manner that absent its permission would violate the Commerce Clause. "It is indeed well settled that Congress may use its power under the Commerce Clause to '[confer] upon the States an ability to restrict the flow of interstate commerce that they would not otherwise enjoy." *New England Power Co. v. New Hampshire*, 455 U.S. 331, 339-40 (1982) (quoting *Lewis v. BT Inv.*

Managers, Inc., 477 U.S. 27, 44 (1980)). For example, Congress could empower the states to regulate utilities in a manner that would discriminate against out-of-state energy companies.

Supreme Court Commerce Clause precedent is abundant, but there is no bright-line test to determine whether a statute violates the Commerce Clause. *See generally Tracy*, __ U.S. at __ n.8, 117 S. Ct. at 820 n.8 (1997) (citing *Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375 (1983) and discussing Court's departure from bright-line test in Commerce Clause examinations of cases dealing with electric utilities). Modem Commerce Clause jurisprudence, therefore, involves a case-by-case examination of whether the statute discriminates against interstate commerce.[6] Thus, we are admonished by the Supreme Court to examine the provisions of the Competition Act at issue here with both deference to Commerce Clause precedent and sensitivity to the unique factual circumstances surrounding the Competition Act.

III.

IPL seeks to have the stranded-cost provisions invalidated as unconstitutional, while permitting the rest of the statute to

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6. Our Commerce Clause jurisprudence is not so rigid as to be controlled by the form by which a State erects barriers to commerce. Rather our cases have eschewed formalism for a sensitive, case-by-case analysis of purposes and effects. As the Court declared over 50 years ago: The commerce clause forbids discrimination, whether forthright or ingenious. In each case it is our duty to determine whether the statute under attack, whatever its name may be, will in its practical operation work discrimination against interstate commerce.

West Lynn Creamery v. Healy, 512 U. S. 186, 201 (1994).

remain in effect. IPL's theory is that by permitting PECO to recover its stranded-costs, the Commonwealth is giving the company a huge financial advantage in the new electric generation market to the detriment of out-of-state electric utilities. To this end, IPL makes a bevy of arguments that these provisions violate the Commerce Clause's prohibition against state laws that discriminate against interstate commerce. Also, IPL argues that these provisions are severable from the Competition Act as a whole and that competition may proceed absent the stranded-cost provisions. We believe that IPL's argument is fraught with contradiction and find that IPL has failed to carry the difficult burden of proving that the stranded-cost provisions violate the Commerce Clause of the United States Constitution. *In re Petition to Recall Reese*, 542 Pa. 114, 119, 665 A.2d 1162, 1164 (1995).

The logical starting point in any examination of an alleged violation of the Commerce Clause is Supreme Court precedent and the guidelines therein. The most obvious violation of the Commerce Clause is a tax on out-of-state products and goods for the purpose of favoring local industry. "The paradigmatic example of a law discriminating against interstate commerce is the protective tariff or customs duty, which taxes goods imported from other states, but does not tax similar products in State." *West Lynn Creamery v. Healy*, 512 U.S. 186, 193 (1994). Since these protective tariffs are obviously unconstitutional, Commerce Clause precedent has been focused more on state statutes that surreptitiously attempt "to reap some of the benefits of tariffs by other means." *Id.*

The Supreme Court has been quick to strike down all classes of state statutes that discriminate against interstate commerce through surreptitious means. *See id.* (invalidating

Massachusetts assessment statute because assessment was in effect tax making out-of-state milk more expensive); *Chemical Waste Management, Inc. v. Hunt*, 504 U.S. 334 (1992) (striking down Alabama statute that imposed additional fee for disposal of hazardous waste generated outside state); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984) (voiding Hawaii tax exemption for liquor products uniquely indigenous to state); *Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. 333 (1977) (nullifying North Carolina shipping requirement because it protected local industry from competition from superior out-of-state product); *Polar Ice Cream & Creamery Co. v. Andrews*, 375 U.S. 361 (1964) (determining that Florida statute requiring company to purchase milk from local producers was unconstitutional); *Toomer v. Witsell*, 334 U.S. 385 (1948) (voiding South Carolina law requiring shrimp boats to dock in local port and unload, pack and stamp fish caught off state's coast); *Baldwin v. G. A. F. Selig, Inc.*, 294 U.S. 511 (1935) (invalidating New York regulation imposed on milk distributors to shield local producers from effects of out-of-state competition); *Guy v. Baltimore*, 100 U.S. 434 (1880) (nullifying Baltimore wharfage tax that exempted Maryland products); *Welton v. Missouri*, 91 U.S. 275 (1876) (striking down Missouri license requirement that only applied to persons dealing in out-of-state goods). However, in surveying Supreme Court precedent we have found no case that speaks directly to the issue presented in the instant appeal.[7] Nevertheless, we have

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7. We, of course, realize that the absence of a case factually identical to the present case is by no means conclusive to the fact that the Competition Act does not violate the Commerce Clause. It is, however, highly illustrative of the novelty of Pennsylvania's Competition Act. The determining factor for us is not the inability to find a case directly on point, but the fact that all the statutes that were struck down by the Supreme Court involved the stifling of interstate commerce

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discovered that in deciding these cases the Supreme Court has developed a modem Commerce Clause approach that focuses primarily on whether the state law would "in its practical operation work discrimination against interstate commerce." *West Lynn Creamery*, 512 U.S. at 201.

After thoroughly reviewing Supreme Court Commerce Clause precedent, we conclude that the Competition Act does not implicate the Commerce Clause for three reasons. First, the Competition Act does not discriminate against interstate commerce and is unlike the state statutes that have been previously examined under the Commerce Clause by the Supreme Court. Second, the provisions of the Competition Act that are questioned as discriminatory (those that allow for the recovery of stranded-costs) are consistent with the traditional ability of states to regulate the retail sales of electricity and do not trigger the dormant aspects of the Commerce Clause. Third, the need for stranded-cost recovery is evidenced by their acceptance in other forums moving toward competition and the Commerce Clause should not be used as an impediment to Pennsylvania's experiment with competition.

A.

The Competition Act, and specifically, the stranded-cost provisions contained in the act, do not implicate the Commerce

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through local favoritism in then currently competitive markets. The Competition Act, read in whole, invites competition into an industry that has been historically limited to state-regulated monopolies, and as such, it is so distinct from Commerce Clause precedent that we must find that it does not involve the Commerce Clause. To hold otherwise would expand Supreme Court precedent, which this Court has neither the power nor desire to do.

Clause because they do not discriminate against interstate commerce and are strikingly unlike laws invalidated in prior Supreme Court decisions addressing the Commerce Clause. Traditional Commerce Clause inquiries involved state statutes that protected local commerce by burdening interstate commerce. The Competition Act is significantly unique because its practical effect is the promotion of competition in an industry that heretofore had none, and the stranded-cost provisions are merely an element of this planned move toward competition. In actuality, the Competition Act is the antithesis of a statute that discriminates against interstate commerce and does not touch on Commerce Clause concerns. We, therefore, believe that allowing the Competition Act to remain in its present form is consistent with the Supreme Court's Commerce Clause jurisprudence because the practical effect of the stranded-cost provisions, and of the Competition Act as a whole, is to facilitate interstate commerce.

IPL argues that the stranded-cost provisions are a surreptitious attempt to discriminate against interstate commerce because, although the Competition Act allows competition, the stranded-cost recovery will give PECO an unfair advantage in the newly formed electric generation market. According to IPL, stranded-cost recovery is tantamount to a huge subsidy that PECO can use to artificially lower its rates for generated electricity to the detriment of out-of-state electric companies.[8] To buttress its argument, IPL analogizes

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8. The characterization of the stranded-cost recoveries as subsidies may present us with another ground for disposing of this case, which we choose not to pursue here. Although, the Supreme Court has not directly addressed the issue of the constitutionality of state subsidies, it has "noted that 'direct subsidization of domestic industry does not

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the present case to the Supreme Court's decision in *West Lynn Creamery*. For IPL to prevail on its Commerce Clause challenge, it first would have to establish that the Commerce Clause is implicated in this matter. To do so, IPL must show that the Competition Act and the stranded-cost provisions discriminate against interstate commerce by affording utilities like PECO an advantage in this newly competitive market. Since IPL has not convinced us that the Competition Act or the stranded-cost provisions afford any such advantage, we fail to see how the Competition Act has any detrimental effect on interstate commerce.

IPL attempts to establish discrimination against interstate commerce by improperly focusing solely on the stranded-cost provisions without according any significance to the Competition Act as a whole. In addition, IPL goes further by mischaracterizing the nature of stranded-cost recovery to support its alleged violation of the Commerce Clause. When this argument is examined closely, there are two striking problems that undermine IPL's contention: first, the practical

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ordinarily run afoul' of the negative Commerce Clause." *West Lynn Creamery*, 512 U.S. at 199 n. 15 (quoting *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 278 (1976); *see also West Lynn Creamery*, 512 U.S. at 211 (stating "I would therefore allow a State to subsidize its domestic industry so long as it does so from nondiscriminatory taxes that go into the State's general revenue fund") (Scalia, J, concurring). The only difference between the stranded-cost recoveries and a direct subsidy is that the state does not involve itself in the collection process. It does, however, involve itself in the process of determining how much the utilities receive. This appears to be a minimal administrative difference that may make the stranded-cost recoveries permissible subsidies. Nevertheless, there are stronger justifications to uphold these provisions.

effect of the Competition Act is undeniably the promotion of interstate commerce; and second, the stranded-cost recoveries are not a fortuitous gift from the Commonwealth to PECO as IPL argues; they represent identifiable and limited reimbursements to which PECO is entitled.

The purpose of the Competition Act is clear: to relinquish the local utilities' monopoly control over the generation of electricity and to invite competition in an effort to lower electric generation rates for the citizens of this Commonwealth. *See generally* 66 Pa. C.S. §2802 (detailing impetus for, and objectives of, Competition Act). The act mandates the creation of "direct access by retail customers to the competitive market for the generation of electricity." 66 Pa. C.S. §2802(12). In addition, the act "requires electric utilities to unbundle their rates and services and to provide open access over their transmission and distribution systems to allow competitive suppliers to generate and sell electricity directly to consumers." 66 Pa. C.S. §2802(14). The Competition Act, therefore, seeks to foster interstate commerce. Any attempt to read the stranded-cost provisions in isolation plainly distorts this avowed goal.

Even assuming that our examination could focus solely on the stranded-cost provisions with no concern for the purpose of the act as a whole, IPL would still fail because its argument erroneously hinges on a convoluted mischaracterization of the stranded-cost provisions. IPL erroneously characterizes stranded-costs as nothing more than "subsidies to high cost Pennsylvania utilities." This is untrue. The stranded-cost provisions allow for an equitable transition into a competitive electric market, and the recovery of stranded-costs is governed by strict guidelines. These guidelines limit both the amount of

recovery and the time period in which the costs may be recovered. 66 Pa. C.S. §2808(b), (c). Moreover, the recoveries are limited to costs "which traditionally would be recoverable under a regulated environment" and are subject to PUC's determination that it is "just and reasonable to recover [these costs] from ratepayers." 66 Pa. C.S. §§2803, 2804(13). In sum, even if we looked no further than the stranded-cost provisions, we would find nothing to implicate the Commerce Clause. The stranded-cost recoveries are better characterized as restitution intended to place PECO where it would have been had regulation continued, rather than as subsidies intended to place PECO at an advantage.

It is further illustrative of the lack of the applicability of the Commerce Clause to our examination here that the precedent most heavily relied on by IPL is factually dissimilar from the case at bar. IPL relies on *West Lynn Creamery* as the Supreme Court precedent most analogous to the issue presented in this appeal, but we are not convinced that *West Lynn Creamery* is dispositive. *West Lynn Creamery* involved a Massachusetts pricing order, the admitted purpose of which was to preserve the local dairy industry. The pricing order subjected all fluid milk sold by dealers to Massachusetts retailers to an assessment. Although about two thirds of the milk was produced by out-of-state dairy farmers, the entire assessment was distributed to Massachusetts dairy farmers. The Supreme Court held that the pricing order violated the Commerce Clause "because its *avowed purpose* and its *undisputed effect* are to enable higher cost Massachusetts dairy farmers to compete with lower cost dairy farmers in other states." *West Lynn Creamery*, 512 U.S. at 194 (emphasis added).

West Lynn Creamery is distinguishable from the present case on many grounds, the most obvious of which is the

differences between the purpose of Massachusetts pricing order and the purpose of the Competition Act. The pricing order's sole objective was to save the financially distressed local dairy industry by shielding it from the rigors of interstate competition. In *West Lynn Creamery*, the Court concluded that this was "the hallmark of the economic protectionism that the Commerce Clause prohibits." *Id.* at 205. Conversely, the Competition Act's *avowed purpose* is to promote competition and interstate commerce by opening the electric generation market. In this regard, it is difficult for us to comprehend how the stranded-cost provisions, which facilitate this move toward more interstate commerce, are like the pricing order in *West Lynn Creamery*.

Moreover, the pricing order in *West Lynn Creamery* and the Competition Act are notably different in other aspects as well. The proceeds from premium payments in *West Lynn Creamery* were collected from both out-of-state and in-state retailers and dealers. Also, the premium payments were not limited in their duration, nor were they in any way related to a history of state regulation of the dairy industry. They were nothing more than gratuitous payments to assist a failing industry, which in effect discriminated against interstate commerce.

In the present case, the stranded-cost provisions of the Competition Act represent a careful and detailed part of Pennsylvania's move toward a competitive electric generation market. As stated previously, these stranded-costs must be recovered within a certain time frame, and they are limited to the sums local utilities spent prudently in reliance on the continuation of a regulated market. *See* 66 Pa. C.S. §2808(b), (c). They are paid strictly by the citizens of the Commonwealth of Pennsylvania to Pennsylvania utilities, and have no direct

effect on out-of-state entities. In addition,, these payments are not gratuitous, but represent compensation for the investments made by utilities that will not be recouped by market-determined pricing. Most importantly, the *effect* of the stranded-cost provisions, as a component of the Competition Act, is the promotion of interstate commerce.

To summarize, the Competition Act, and the stranded-cost provisions contained therein, do not involve the Commerce Clause because they do not discriminate against interstate commerce. Allowing the act to remain as enacted by the General Assembly is consistent with Supreme Court precedent because the practical effect of the act is to promote competition. The stranded-cost provisions, which are an integral part of Pennsylvania's plan to open its electric markets to interstate competition, cannot be examined outside of the context of the entire act. The provisions limit stranded-cost recoveries both in terms of amounts and duration, and afford no unfair advantage to Pennsylvania utilities in the new electric generation market.

B.

IPL's argument that the stranded-cost provisions violate the Commerce Clause is also undermined by the fact that these provisions are consistent with Pennsylvania's right to regulate the local incidents of public utilities, most notably, the rates charged by local utilities to consumers within the state. The transition charges are nothing more than a different manifestation of the previously regulated rates. Had Pennsylvania continued the system in effect prior to the Competition Act, PUC would have allowed PECO to recover these costs through the rates it charged for its "bundled" services without labeling them transition charges. The stranded-cost

provisions are simply a novel way to accommodate the need for recovery of these costs consistent with traditional state regulation.

Historically, states have regulated the rates charged by local utilities to their in-state customers, and Congress has never disturbed the states' right to do so even though it has assumed power over some other areas of utility regulation. Moreover, if Congress has spoken directly to the issue of the states' power over local utilities, it appears to have apportioned to the states the right to regulate these utilities in local respects. Thus, the stranded-cost provisions do not implicate the dormant aspects of the Commerce Clause because states have traditionally regulated in this area, and the evidence seems to indicate that Congress has apportioned this right to the states.

The gas and electric industries shared a similar fate at their inception in that it became an economic necessity for states to permit local monopolies in order for these industries to remain profitable. *Tracy*, __ U.S. at __, 117 S. Ct. at 819-20. The monopoly power of these franchises was "balanced by regulation and the imposition of obligations to the consuming public upon the franchised retailers" at the state level. *Tracy*, __ U.S. at __, 117 S. Ct. at 820. Essentially, utilities were principally an intrastate concern at this point. This began to change in the early twentieth century, when the natural gas industry, and later the electric industry, developed into more interstate concerns.

As a corollary, the Supreme Court eventually confronted the issue of whether state regulation of the sale of natural gas in interstate commerce violated the Commerce Clause. Through its disposition of several cases, the Supreme Court devised a bright-line test to determine whether a state regulation of natural

gas sales violated the Commerce Clause. *See generally Missouri v. Kansas Gas Co.*, 265 U.S. 298 (1924) (holding that attempt by state to fix rates chargeable in sale of natural gas to distributor in another state is direct burden on interstate commerce); *Pub. Util. Comm'n for Kansas v. Landon*, 249 U.S. 236 (1919) (finding that piping natural gas from one state to another is interstate commerce, but retail sale of same natural gas is not); *cf. Pennsylvania Gas Co. v. Pub. Serv. Comm'n of New York*, 252 U.S. 23 (1920) (deciding that even though natural gas sold from company in one state directly to consumers in another state is interstate commerce, state can regulate these sales in absence of contrary Congressional regulation). The Supreme Court proceeded with the notion that wholesale transactions of natural gas had a direct effect on interstate commerce, whereas retail sales had only an indirect effect on interstate commerce. *Arkansas*, 461 U.S. at 378. As a result, a general rule emerged that state regulation involving wholesale transactions of natural gas violated the Commerce Clause, while state regulation of retail sales did not. *Id.*

The wholesale-retail distinction was adopted in the context of the electric industry by the Supreme Court's decision in *Pub. Util. Comm'n of Rhode Island v. Attleboro Steam & Elec. Lighting Co.*, 273 U.S. 83 (1927). In *Attleboro*, the Supreme Court addressed the issue of whether a state regulatory commission could regulate the rates that a local utility charged in selling its electric current to an out-of-state distributor. The Court held that the state's attempt to regulate the wholesale transaction "imposed a 'direct' rather than an 'indirect' burden on interstate commerce, and as such, the regulation violated the Commerce Clause." *Arkansas*, 461 U.S. at 378-79.[9]

9. The *Arkansas* Court noted that the wholesale-retail distinction was no longer workable and applied a test more in line with the general

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Appendix A

The *Attleboro* decision sparked the creation by Congress of what is today the Federal Energy Regulatory Commission (FERC) and the establishment of federal regulations over wholesale transactions of gas and electricity. *Arkansas*, 461 U.S. at 378-79. These regulations were first seen in the Federal Power Act of 1935 (FPA), 16 U.S.C. §§791a-828c, and subsequently in the Natural Gas Act of 1938 (NGA), 15 U.S.C. §§717-717z (1997). *Arkansas*, 461 U.S. at 378-79. "[T]he main purpose of this legislation was to 'fill the gap' created by Attleboro and its predecessors" in setting guidelines for federal and state regulation of electric and natural gas utilities. *Id.* at 379. Congress assumed some regulatory authority through this legislation, but in no way impinged on the states' authority to regulate utilities at the local level. In fact, Congress was careful to leave intact the states' ability to regulate the most local aspects of the industry, which would necessarily include setting rates for local consumers.

The Supreme Court had occasion to discuss the care that Congress took not to disturb the state regulation of electric utilities at the local level in *Connecticut Light & Power v. Fed. Power Comm'n*, 324 U.S. 515 (1945). *Connecticut Light* involved an order by the Federal Power Commission (FPC), the predecessor of the FERC, requiring a Connecticut electric utility to use accounting procedures mandated by the FPA despite the fact that the company's business was completely

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trend in the Court's modern Commerce Clause jurisprudence. The Court stated that this modern approach looked "in every case to the nature of the state regulation involved, the objective of the state, and the effect of the regulation upon the national interest in the commerce." 461 U.S. at 390 (1983) (citing *Illinois Natural Gas Co. v. Cent. Illinois Pub. Serv. Co.*, 314 U.S. 498, 505 (1942)).

local in nature. The Court closely examined the provisions of the FPA empowering the FPC and found that the FPC overstepped its bounds by ordering the use of certain accounting procedures. The Court stated that through the FPA "Congress . . . was trying to reconcile the claims of federal and of local authorities and to apportion federal and state jurisdiction over the industry." *Connecticut Light*, 324 U.S. at 531. Additionally, the Court was especially cognizant of the legislative history of the FPA in which Congress communicated its belief that the FPA did not give the FPC "jurisdiction over local rates." *Id.* at 525-28. The Court also cited a House of Representatives report which stated that "no jurisdiction is given over local distribution of electric energy, and the authority of States to fix local rates is not disturbed even in those cases where the energy is brought in from another state." *Id.* at 527 (citing H.R. Rep. No. 1318, 74th Cong., 1st Sess. 7, 8, 27 (1935)); *cf. Panhandle Eastern Pipeline Co. v. Pub. Serv. Comm'n of Indiana*, 332 U.S. 507 (1947) (holding NGA extended federal regulation only to area which Supreme Court had held state could not reach and did not usurp state authority).

With this background in mind, we believe that the stranded-cost provisions are consistent with traditional state regulation of the local effects of state utilities for two reasons. First, the competitive transition charges are completely intrastate and have no real effect on interstate commerce. These charges are collected from consumers within the state by utilities located within the state, and they are tied to the transmission and distribution network wholly within this Commonwealth. Second, states continue to maintain the traditional police power to fix reasonable charges for the sale of electricity at the local level despite Congress's assumption of some regulatory authority over utilities. *Cf. Tracy*, __ U.S.

at __ n.8, 117 S. Ct. at 820 n.8 (discussing how all state regulation is not immune from Commerce Clause jurisprudence); *see also Camps Newfound/Owatonna v. Town of Harrison*, __ U. S. __, __, 117 S. Ct. 1590, 1614 (1997) (proffering that Tracy creates a "public utilities" exception to the dormant commerce clause) (Scalia, J., dissenting). Had Pennsylvania continued its previous regulatory scheme, it would have undoubtedly permitted the recovery of stranded-costs through regulated rates, and there is no justification for disallowing these recoveries in a new competitive market.

The competitive transition charges are completely intrastate in nature, and any alleged effect on interstate commerce is completely illusory. The language of the statute detailing the assessment of these charges gives credence to this position: "every customer accessing the transmission or distribution network shall pay a competitive transition charge to the electric distribution company in whose certificated territory that customer is located." 66 Pa. C.S. §2808(a). Thus, it is inescapably apparent that the charges are levied only on Pennsylvania residents and are directly connected to an undeniably intrastate concern (i.e., local electricity transmission and distribution networks). It escapes our collective logic that these charges could be deemed anything other than completely intrastate in nature.

Furthermore, the stranded-cost provisions are consistent with Pennsylvania's historical regulation of local utility rates, a power that appears to have been specifically apportioned to it by Congress. In this vein, the General Assembly of Pennsylvania has empowered the PUC to set "just and reasonable" rates for electricity and to generally oversee electric utilities in the interest of the public welfare. *See* 66 Pa. C.S.

§§1301-14. This Court has stated, and the Pennsylvania Supreme Court has agreed, that "the Commission has an ongoing duty to protect the public from unreasonable rates while insuring that utility companies are permitted to charge rates sufficient to cover their costs and provide a reasonable rate of return." *Pennsylvania Pub. Util. Comm'n v. Philadelphia Elec. Co.*, 522 Pa. 338, 343-44, 561 A.2d 1224, 1226 (1989) (citing *Metropolitan Edison v. Pennsylvania Pub. Util. Comm'n*, 437 A.2d 76 (1981)) (citation omitted); *see also Popowsky v. Pennsylvania Pub. Util. Comm'n*, 683 A.2d 958, 961 (Pa. Cmwlth. 1996) ("PUC has broad discretion in determining whether rates are reasonable"). The Competition Act in no way intended to diminish Pennsylvania's power to regulate local utility rates to ensure fair rates for the public and a reasonable return on investment for the utilities. In fact, the stranded-cost provisions specifically rely on a continuation of PUC oversight in setting of "just and reasonable" electricity rates to facilitate the move toward a competitive market.

In sum, IPL's argument is misplaced because the Competition Act's stranded-cost provisions affect only intrastate concerns and are consistent with Pennsylvania's ability to regulate local utility rates. Pennsylvania consumers pay them to Pennsylvania utilities in relation to transmission and distribution networks exclusively in Pennsylvania. Moreover, the stranded-cost provisions rely on the traditional state power, which appears to have been apportioned to the states by Congress, to set just and reasonable local utility rates.

C.

We are also convinced that the implementation of stranded-cost recovery mechanisms in other forums is

compelling evidence that the Commerce Clause should not be used to hinder Pennsylvania's experiment with competitive electric generation. The move toward competitive utility markets is a national trend,[10] and the recovery of stranded-costs is by no means isolated to the Competition Act. Those regulatory bodies, both federal and local, whose expertise has been relied on to facilitate the move toward open markets, seem to agree that the need for these recoveries is essential. As such, we are compelled to defer to PUC's decision to model Pennsylvania's move toward competition after these other forums, and we see no justification for implicating the Commerce Clause in derailing this ambitious endeavor.

There is a hint of disingenuousness in IPL's attempt to implicate the Commerce Clause in this matter. The Commerce Clause was intended to serve as a shield against provincialism so as to promote a national economy. In the present case, IPL's alleged constitutional violation uses the Commerce Clause as a sword to attack the stranded-cost provisions in order to foster its own competitive advantage.[11] To accept IPL's position would

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10. It is worth noting that Pennsylvania is also exploring deregulation of its gas utilities. *See* Rich Heidorn, Jr., *Gas Deregulation Could Be Next for Pa.'s Consumers*, Philadelphia Inquirer, Feb. 16, 1997, Section E, at 1.

11. IPL is asking us to strike down the stranded-cost provisions because it believes the provisions confer a benefit on PECO to the detriment of IPL. The stranded-cost recoveries represent recovery of the costs to which PECO and other Pennsylvania utilities would have been entitled had regulation continued. IPL is recovering these same costs from its monopoly franchise in Indiana. Disallowing PECO's stranded-cost recovery would surely benefit IPL in that PECO's financial position would be compromised, but IPL would be able to continue

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undermine the history and purpose of stranded-cost recovery and the Competition Act.

The concept of stranded-cost recovery began in the natural gas industry and was soon applied to the electric industry. FERC addressed the concept in Order 636,[12] which required natural gas pipelines to open up their transportation services to customers who purchased their gas from a supplier other than the pipeline owner. The Order was intended to guarantee that

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recovering similar costs under Indiana's regulatory scheme. See Ind. Code Ann. §§8-1-2-1-8-1-2-126 (Burns 1998) (detailing the powers of the Indiana Utility Regulatory Commission); Ind. Admin. Code tit. 170, rr. 4-1-1-4-6-23 (1998) (dealing with electric utility regulation).

It is worthy of note that the Indiana Court of Appeals has held in a decision involving IPL's request for a rate increase that the Commission's primary objective is to reach an overall result that is fair to utilities, and which will permit continuity of utility services on a sound financial basis. *L.S. Ayers & Co. v. Indianapolis Power & Light Co.*, 169 Ind. App. 652, 351 N.E.2d 814 (1976). In *L.S. Ayers*, the Court stated that a:

> [P]ublic utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties.

169 Ind. App. at 660, 351 N.E.2d at 821. Likewise, overall fairness is at the foundation of PUC decision here.

12. *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Partial Wellhead Decontrol*, 57 Fed. Reg. 13, 267 (April 16, 1992).

there were equal interstate transportation services for all gas suppliers to allow for the "unbundling" of interstate natural gas sales. FERC was aware that that this "unbundling" procedure would burden the pipelines with stranded-costs.[13] As a result, FERC allowed for the recovery of "prudently incurred costs" through a process of petitioning FERC. *See* 57 Fed. Reg. 13,267, 13,309 (April 16, 1992); *see also United Distribution Companies*, 88 F.3d 1105 (D.C. Cir. 1996) (rejecting challenge to FERC procedure for recovery of stranded-costs).

In turn, FERC also included stranded-cost recoveries in the context of the interstate electric industry in Order 888.[14] Order 888 required all utilities that owned, controlled, or operated facilities used in transmitting electricity in intrastate commerce to provide open access to their facilities to other utilities. The order was intended to facilitate the move from a "monopoly-regulated industry to one in which all sellers [could] compete on a fair basis and in which electricity [was] more competitively priced." 61 Fed. Reg. 21,540, 21,542 (May 10, 1996). FERC addressed stranded-costs in Order 888 and determined that it was necessary to allow "utilities to recover their legitimate, prudent and verifiable stranded-costs simultaneously with . . . requiring open access of transmission." *Id.* at 21,629.

In the present case, the Competition Act was the result of a year-long study by PUC into the viability of competitive

13. Order 636 describes stranded-costs as "costs now incurred by pipelines in connection with their bundled sales services that cannot be directly allocated to customers of unbundled services." 57 Fed. Reg. at 13, 309.

14. *Recovery of Stranded Costs by Public Utilities and Transmitting Utilities*, 61 Fed. Reg. 21,540 (May 10, 1996).

electric generation. At the conclusion of this study, PUC presented to the governor a report detailing its proposed guidelines for opening electric generation to competition. In this report, PUC noted that "[d]ealing with stranded-costs is one of the most difficult issues to be resolved in our efforts to a competitive electric industry." *Pennsylvania Public Utility Commission, Report and Recommendation to the Governor and General Assembly on Electric Competition*, Docket No. 1-940032, p. 14 (July 3, 1996). PUC was understandably concerned with this aspect of the move toward competition, and it devoted a great deal of its report in setting guidelines for stranded-cost recovery. *See id.* p. 14-25.

It is not beyond peradventure to assume that PUC was well aware of the mechanisms being used in other forums to deal with the problems of stranded-costs. PUC's decision to recommend stranded-cost recoveries as part of the Competition Act was on all accounts a prudent and necessary element of the move toward competition, and at least one other state utility commission has come to the same conclusion.[15] As reflected in the Competition Act, the stranded-cost provisions are equitable and allow for a fair transition toward a competitive generation market. As reflected in the qualified rate order that is the subject of this appeal, we must defer to PUC's determination that these recoveries are warranted and just. *W.C. McQuaide, Inc. v. Pennsylvania Pub. Util. Comm'n*, 585 A.2d 1151, 1154 (Pa. Cmwlth. 1991) ("We defer to the PUC on matters within its

15. *See* Cal. Pub. Util. Code §330(s) (West 1996) (stating that "[i]t is proper to allow electrical corporations an opportunity to continue to recover, over a reasonable transition period, those costs . . . that may not be recoverable in market prices in a competitive generation market); *see also* Cal. Pub. Code §§840-44 (West 1996) (relating to financing of transition costs).

administrative expertise"). This Court lacks the expertise and resources to delve into the mechanics of PUC's order, and we have been presented no reason to believe that the order is improper.

In any event, we do not believe that the Commerce Clause was intended to be used to strike down endeavors like the one on which Pennsylvania has embarked. The words of Justice Brandeis are worth repeating to underscore this point:

> To stay experimentation in things social and economic is a grave responsibility. Denial of the right to experiment may be frought [sic] with serious consequences to the Nation. It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country.

West Lynn Creamery, 512 U.S. at 216 (Rehnquist, C.J., dissenting) (quoting *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting)); *see also Connecticut Light*, 324 U.S. at 530, (stating that "'insulated chambers of the states are still laboratories where many lessons in regulation may be learned by trial and error on a small scale without involving a whole national industry in every experiment"). We need not go into great detail to emphasize the resources that have already been expended in pursuit of this endeavor, nor do we need to highlight all that would be lost if we were to accept IPL's argument. Suffice it to say, we believe that this experiment must proceed.

In summation, we find that the Competition Act does not implicate the Commerce Clause. The Competition Act, read in

its entirety, is the antithesis of a statute that violates the Commerce Clause because it actually invites out-of-state competition in an area where states have been traditionally permitted to exclude such competition. This same tradition has allowed states to freely set local utility rates, and the stranded-cost provisions are consistent with this tradition. In addition, the need for stranded-cost recovery has been evidenced in other forums moving toward competition, and we feel that the Commerce Clause should not be used as an impediment to Pennsylvania's ambitious experiment with competition.

IV.

We now briefly turn to addressing IPL's other arguments for the sake of thoroughness and to emphasize the implausibility of severing the stranded-cost provisions from the Competition Act as IPL desires. If we were to assume that the Competition Act implicates the Commerce Clause, the act must be viewed against a two-tiered test established by the United States Supreme Court. In this two-tiered test, a determination must first be made whether the act, either on its face or in its effect, discriminates against interstate commerce. If so, the act is "per se invalid, save in a narrow class of cases in which the [state] can demonstrate, under rigorous scrutiny, that it has no other means to advance a legitimate local interest." *C&A Carbone, Inc., v. Clarkstown*, 511 U.S. 383, 392 (1994). In the absence of direct discrimination, a determination must then be made whether the act has an incidental effect on interstate commerce. If there is an incidental effect on interstate commerce, then the statute is constitutional unless the "burden imposed on interstate commerce is clearly excessive in relation to the putative local benefits." *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970). We believe that the act would still survive if subjected to this two-tiered test.

Appendix A

A.

We will begin by examining the stranded-cost provisions in relation to the second tier of the Constitutional test because we are convinced that the Competition Act as a whole does not discriminate in purpose or effect. The basis for our belief was set out in detail above, but is worth repeating. We believe that the true purpose of the act is to promote competition. We also believe that the stranded-cost provisions are an integral part of this move toward competition and are in no way a surreptitious attempt to discriminate against interstate commerce. Moreover, the Competition Act and the stranded-cost recoveries have no discriminatory effect on interstate commerce because the recoveries are purely intrastate concerns and afford no unfair advantage to local utilities. Therefore, we believe that, at most, the Competition Act and the stranded-cost provisions have an incidental effect on interstate commerce, and that they are constitutional unless the "burden imposed on interstate commerce is clearly excessive in relation to the putative local benefits." *Id.*

IPL contends that by allowing local utilities to recover these stranded-costs, Pennsylvania has placed a burden on interstate commerce that is clearly excessive in relation to the putative local benefit. In addition, IPL argues that these local interests could be promoted as well with a lesser impact on interstate commerce. We disagree. The local concerns encompassed by the stranded-cost recoveries are profound and clearly outweigh any alleged burden on interstate commerce. IPL has also failed to present this Court with a reasonable alternative to the stranded-cost recoveries that would impact interstate commerce less.[16]

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16. The only alternative that IPL presents this Court is to require PECO to divest itself of all its generating facilities in exchange for

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Appendix A

We believe that Pennsylvania's interest in regulating the retail sales of electric utilities, as discussed in section III. B. above, is enough to uphold the stranded-cost provisions under the Commerce Clause. However, there are many other local interests that are sufficient, independently, to uphold the act. An exhaustive examination of all the other local concerns that support the constitutionality of the stranded-cost provisions is unnecessary, as we believe that highlighting a handful of these concerns is sufficient to illustrate the shortcomings of IPI 's argument.

To begin, we believe that the need to insure the future viability of Pennsylvania electric utilities in the period of transition toward competition is of preeminent local concern. PECO will be entitled to recover over $5 billion in stranded-costs during the transition toward competition. These sums would have been recovered under the prior regulated scheme to afford PECO a fair return on its investments. Without these recoveries there is no guarantee that PECO will remain a viable entity. There can be no doubt that in general there is a strong need for viable local electric utilities. With respect to the present case, there are two needs which are of particular importance: first, the need to maintain the transmission and distribution networks located in Pennsylvania, and second, the

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recovery of its stranded-costs. Requiring utilities to divest themselves of their generating facilities would not only raise the issue of an unconstitutional taking, but would also jeopardize Pennsylvania's electric utility service for the same reasons discussed in Section III. B. above. It is foreseeable that many local electric utilities in Pennsylvania will be entitled to stranded-cost recoveries. If they were all required to divest themselves of their generating facilities, Pennsylvania could be left with little or no local electric generation capacity. This is hardly a reasonable alternative.

need to have reliable service for all Pennsylvania consumers at all times.

As part of the move toward competition, the General Assembly believed that "the electric industry restructuring should ensure the reliability of the interconnected electric system by maintaining the efficiency of the transmission and distribution system." 66 Pa. C.S. 2808(2). To this end, the General Assembly included language in the Competition Act that directly relates the recovery of stranded-costs to this transmission and distribution system. *See* 66 Pa. C.S. 2808(2). Without stranded-cost recoveries the transmission and distribution networks maintained by PECO would be placed in peril. At the end of the day, there may not be any network for IPL to use in competing with PECO and other utilities if stranded-cost recoveries were disallowed. In this event, any benefit IPL could gain from competition would be completely undermined. More important, electric service in Pennsylvania altogether could be jeopardized. These stranded-cost recoveries are essential to insuring that Pennsylvania has local utilities that can maintain the transmission and distribution networks so electricity, including that generated by IPL, can reach Pennsylvania consumers and so competition can proceed.

Another related concern is the need to insure that Pennsylvania consumers have viable energy companies in the event that out-of-state electric generation companies cannot supply all the energy needs of all classes of Pennsylvania consumers. Pennsylvania utilities will still serve as the provider of last resort to bridge the gap when out-of-state suppliers do not have enough electricity to service Pennsylvania consumers. 66 Pa. C.S. §2802(16). In addition, local utilities will still have a responsibility to serve low-income segments of

Pennsylvania's population, which obviously is not as profitable as servicing the population at large. 66 Pa. C.S. §2802(10). On the other hand, out-of-state utilities, like IPL, enter the state under their own volition and they can just as easily leave to sell their energy somewhere more profitable. The additional responsibilities placed on PECO, like the stranded-cost recoveries, are a by-product of past regulation and are a continuing local concern in the new competitive market.

The need for viable local utilities is vital for the future of the Commonwealth of Pennsylvania, and any burden placed on interstate commerce by the recoveries needed to insure the continuation of these local utilities is not clearly excessive. The success of the transition toward competition is highly dependent on solid transmission and distribution networks, which must be maintained by local utilities. In addition, these local utilities are burdened with obligations not shared with out-of-state competitors to serve as the guarantor of universal electric service. We cannot envision many more important local concerns than the need for viable local electric companies, and we fail to see how IPL's alleged burden is clearly excessive in relation to the need for viable local utilities.[17]

Another local concern that cannot be denied is the need to guarantee that electric utilities have the necessary funds to decommission nuclear power plants and to remove spent radioactive fuel from these plants. Previously, these costs were

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17. Without going into prolonged discussion we would like to note that we believe that this local concern is of such a profound magnitude that it could possibly survive the per se unconstitutional test of *Carbone*. We believe that any purported "discrimination is demonstrably justified by a valid factor unrelated to economic protectionism." *New Energy*, 486 U.S. at 274.

collected in rates over the life of the plant so that all ratepayers paid an equal share, but this will be impossible in an open market. These expenses are just one example of costs that will become stranded in the move toward competition that was of concern to the General Assembly. *See* 66 Pa. C.S. §2808(c)(1). It goes without saying that Pennsylvania has an important local interest in insuring that local utilities are financially able to decommission plants and to remove the radioactive materials stored there. Again, we are not convinced that IPL has been subjected to a burden in clear excess of this local concern.

A last local concern is seen in Pennsylvania's obligation to "resolve certain transitional issues in a manner that is fair to . . . electric utilities, investors, and the employees of electric utilities." 66 Pa. C.S. §2802(8). We need not elaborate in great detail what we perceive as the devastating repercussions that utilities, their stockholders, and their employees will suffer if utilities are denied stranded-cost recoveries. Denying PECO over $5 billion, to which it is entitled, will surely place the company in a compromised financial position at the very time when it becomes subject to competition. In sum, Pennsylvania has an obligation to be fair in its experiment with competition, and any burden caused by the Commonwealth's desire to foster this local concern is not clearly excessive.

B.

Finally, we turn to addressing IPL's arguments that the provision are on their face and in effect discriminatory, and that the provisions are severable from the act as a whole. We chose to address these arguments together because we feel that if we were to accept IPL's position that the stranded-cost provisions are in purpose and/or effect discriminatory, we would

inevitably conclude that the entire Competition Act would have to be struck down. We feel that it is implausible to sever the stranded-cost provisions from the act as whole because the General Assembly never envisioned competition on the terms that IPL is suggesting. As such, examining these arguments together brings to the fore the contradictory nature of IPL's position because it would lead us to eradicate the very thing that gives IPL standing before this Court.

Accepting IPL's argument that the stranded-cost provisions are discriminatory in purpose and effect, despite the compelling evidence otherwise, is outcome determinative. The provisions would be per se invalid unless the state can demonstrate, under rigorous scrutiny, that it has no other means to advance a legitimate local interest. *C&A Carbone*, 511 U.S. 383. The burden that this would place on the state would be very difficult to overcome, and we do not think for our purposes here that it would be productive to discuss whether the state has other means to advance its local interest. Therefore, if we assume that the provisions are purposely and/or effectively discriminatory, it is also safe to assume that we would be required to strike down the stranded-cost provision as unconstitutional.

IPL would then have us sever the stranded-cost provisions. IPL bases its severability argument on the severability clause contained in the act, *See* Act of Dec. 3, 1996, P.L. 802, No. 138, §5, and the public policy favoring severability. *Commonwealth, Dept. of Education v. First School*, 471 Pa. 471, 370 A.2d 702, (1977). In addition, IPL argues that the issue of severability is a matter of statutory construction and legislative intent. Although we agree with the way IPL has framed the issue, we believe that severing the stranded-cost

provisions would mutilate the Competition Act and would be contrary to the intent of the General Assembly. Severing the provisions would also jeopardize the transition toward competition to everyone's detriment and would place Pennsylvania's local utilities in a precarious and unfair financial position.

Even when a statute contains a severability clause, this Court is empowered to nullify an entire statute when severing the challenged provisions would result in a departure from the legislative intent of the statute or when the challenged provision are integral to the statute as a whole.[18] We believe this case presents a situation where the provisions are not severable for both reasons. Dealing with stranded-cost recoveries was regarded as one of the most difficult tasks in moving toward competition by PUC. In addition, the General Assembly recognized the difficulty and importance of stranded-cost recoveries and empowered PUC "to determine the level of

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18. The Statutory Construction Act provides that provisions of a statute shall be severable unless:

> [T]he court finds that the valid provisions of the statute are essentially and inseparably connected with, and so depended upon, the void provision or application, that it cannot be presumed the General Assembly would have enacted the remaining valid provisions without the void one; or unless the court finds that the remaining valid provisions, standing alone are incomplete and are incapable of being executed in accordance with the legislative intent

1 Pa. C.S. §1925; *see also West Shore School Dist. v. Pennsylvania Labor Relations Bd.*, 570 A.2d 1354, 1359 (Pa. Cmwlth. 1990), *aff'd*, 534 Pa. 164, 626 A.2d 1131 (1993) (discussing deference to severability clause unless legislative intent is destroyed or provisions are integral).

transition or stranded-cost for each utility" and to allow "recovery of an appropriate amount of such costs in accordance with the standards established" under the act. 66 Pa C.S. §2802(16). Moreover, the General Assembly went to great lengths to set certain guidelines for the recovery of stranded-costs, and it tied stranded-cost recoveries to the local utilities' continuing obligation to maintain transmission and distribution networks. 66 Pa. C.S. §2808. Severing these provisions is in our minds implausible since they were regarded as so essential to the transition toward competition envisioned by the General Assembly and are so interwoven with the local utilities' continuing obligation to maintain transmission and distribution networks.

The General Assembly was aware that the Competition Act was an experiment that would occasion some transitional problems. To address these problems, the General Assembly included provisions in that act that would insure that those local concerns discussed above (i.e., viable electric companies, nuclear decommissioning costs, and fairness) were protected. We are certain that the General Assembly would not have chosen to proceed with the move toward competition if it would have jeopardized electric service in Pennsylvania as IPL would have us do.

In conclusion, we hold that the Competition Act does not involve the Commerce Clause because the act promotes competition on equitable terms and because the stranded-cost provisions are consistent with traditional state regulation of local electric rates. Also, the use of stranded-cost recovery is part of the national trend toward competitive utility markets, and the Commerce Clause should not serve as a detriment to Pennsylvania's ambitious experiment. In addition, the

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Competition Act and the stranded-cost provisions would survive an application of the Supreme Court's Commerce Clause jurisprudence because any effect that the act or provisions have on interstate commerce is incidental and supported by strong, if not compelling, local concerns.

Accordingly, the order of the PUC is affirmed.

s/ James Gardner Colins
JAMES GARDNER COLINS,
President Judge

APPENDIX B — ORDER OF THE COMMONWEALTH COURT OF PENNSYLVANIA DATED AND ENTERED MAY 7, 1998

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

No. 1597 C.D. 1997

INDIANAPOLIS POWER & LIGHT COMPANY,

Petitioner

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,

Respondent

ORDER

AND NOW, this 7th day of May, 1998, the order of the Pennsylvania Public Utility Commission in the above-captioned matter is affirmed.

s/ James Gardner Colins
JAMES GARDNER COLINS,
President Judge

APPENDIX C — OPINION AND QUALIFIED RATE ORDER OF THE PENNSYLVANIA PUBLIC UTILITY COMMISSION DATED MAY 22, 1997

BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

Commissioners Present: Public Meeting held May 22, 1997

John M. Quain, Chairman, **Statement attached**
Robert K. Bloom, Vice Chairman
John Hanger, **Statement attached**
David W. Rolka, **Dissenting in part — Opinion attached**
Nora Mead Brownell

Docket Nos.
R-00973877
R-00973877C0001
R-00973877C0002

Application of PECO Energy Company For Issuance Of A Qualified Rate Order Under Sections 2808 and 2812 Of The Public Utility Code

Pennsylvania Public Utility Commission, Office of Consumer Advocate, The Environmentalists, Office of Trial Staff, Office of Small Business Advocate and Consumers' Education and Protective Association, *et al.*, Honorable Vincent J. Fumo, Senator, Honorable Angel L. Ortiz, Councilman, Allegheny Power, Indianapolis Power and Light Company, Enron Capital and Trade Resources, Pennsylvania Power and Light Company, Minority Energy Coalition, GPU Energy, Lance Haver, and Philadelphia Area Industrial Energy Users Group,

Intervenors

v.

PECO Energy Company

Appendix C

OPINION AND QUALIFIED RATE ORDER

May 22, 1997

I. Introduction and Overview

On December 3, 1996, Governor Thomas J. Ridge signed into law Act 138 entitled "the Electricity Generation Customer Choice and Competition Act" (the Act). The Act is reduced to law in the Public Utility Code (the Code), at 66 Pa. C.S. §2801, *et seq*. The Act provides a detailed legislative scheme for the restructuring of the Pennsylvania electric industry by, in part, allowing retail customers the opportunity to choose their generation supplier beginning January 1, 1999. (66 Pa. C.S. §2806).

A provision of the Act at 66 Pa. C.S. §2806(d) requires that each electric utility in the Commonwealth submit to the Commission a restructuring plan between April 1, 1997 and September 30, 1997. The plan will, in effect, restructure the rates, rules, regulations and practices of each jurisdictional electric utility in accordance with the intention of the Act and meet the new market structure. The ultimate goal of the restructure is to deregulate the generation function of electric service.

In connection with the restructuring of the electric utilities, the Commission is authorized to issue a Qualified Rate Order[1] (QRO) to facilitate the recovery or financing of qualified

1. A Qualified Rate Order is an Order of the Commission adopted in accordance with Section 2812 of the Competition Act, authorizing the imposition and collection of intangible transition charges. 66 Pa C.S. §2812(g).

transition expenses of an electric utility or assignee. Subsequent to the effective date of the Act, an electric utility may file an application for a QRO concurrently with, prior to, during or following the filing of its restructuring plan under Section 2806. (66 Pa. C.S. §2812(a)(2)(ii)).

Moreover, a utility has the option to request expedited review by the Commission of its request for a QRO, in which case, the Commission must render its final determination on the request within 120 days after the request for expedited review. (66 Pa. C.S. §2812(b)). Applications for QROs must contain the following elements:

> (i) a complete accounting of the utility's transition or stranded costs;
>
> (ii) detailed information regarding the utility's proposal for the sale of intangible transition property or the issuance of transition bonds, and
>
> (iii) information regarding the electric utility's planned use of the proceeds.

66 Pa. C.S. §2812(a)(2)(i).

After notice and opportunity to be heard, the Commission may issue a final QRO for all or a portion of the amount of the transition or stranded costs that it determines to be just and reasonable for the utility to recover from ratepayers under Section 2804 (concerning standards) and 2808 (concerning the Competitive Transition Charge). The Commission is authorized

to issue a final QRO only for the amounts which it finds to be in the public interest.[2] (66 Pa. C.S. §2812(a)(2)(iii)).

II. History of the Proceeding

PECO Energy Company (PECO or Company) proffered the following history of its Application for Issuance (Application) of a QRO:

> PECO filed its Application for a Qualified Rate Order on January 22, 1997 and concurrently served copies of its filing on the Offices of Trial Staff (OTS), Consumer Advocate (OCA) and Small Business Advocate (OSBA) and on the Philadelphia Area Industrial Energy Users Group (PAIEUG). The Company [PECO] also provided immediate notice of its Application to all of the other parties which actively participated in its last electric base rate case, among other interested parties, and began including bill inserts commencing with all bills issued on the date of the filing. In addition, PECO published notice of the Application in all newspapers of general circulation in its service territory and proposed that notice be published promptly in the *Pennsylvania Bulletin*, which it was on February 1, 1997.

(PECO M.B., p. 5). (Footnotes omitted.)

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2. The Commission must complete its review of the Application and issue its final determination by no later than nine (9) months from the filing, unless the utility requests expedited treatment under 66 Pa. C.S. §2812(b), or 15 days after the utility has filed its restructuring plan pursuant to 66 Pa. C.S. §§2806, 2812(a)(2)(iii).

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Formal Complaints in this proceeding were filed by the OCA and an *ad hoc* group which includes: Delaware Valley Citizens' Council for Clean Air, Citizen Action, NESIP, Pennsylvania Public Interest Research Group, Philadelphia Solar Energy Association, Sierra Club and Trout Unlimited – Pennsylvania Council (collectively referred to as Environmentalists).

The following parties were designated as intervenors: Action Alliance of Senior Citizens, Tenant Action Group, John W. Long, Jr., Consumers' Education and Protective Association (the preceding parties were all represented by the same attorney and will be referred to as CEPA). Senator Vincent J. Fumo (Senator Fumo), Councilman Angel L. Ortiz, West Penn Power Company t/a Allegheny Power, Indianapolis Power & Light Company (IP&L). Enron Capital & Trade Resources (Enron), Pennsylvania Power & Light Company (PP&L), Minority Energy Coalition (the Coalition included the Greater Philadelphia Urban Affairs Coalition, the Hispanic Association of Contractors and Enterprises, Intercultural Family Services, Inc., the Urban League of Philadelphia, and the Partnership CDC.), Metropolitan Edison Company and Pennsylvania Electric Company (individually and collectively trading as GPU Energy) (GPU), Lance Haver and the Philadelphia Area Industrial Energy Users Group (PAIEUG). PAIEUG included Air Liquide America Corporation, Allied Signal, Inc. – Fibers Division, Boeing Defense & Space Group – Helicopters Division, The Budd Company, Ford Motor Company, Lukens Inc., Merck & Co. Inc., Nabisco Inc., Occidental Chemical Corporation, Rohm and Haas Company, Smith Kline Beecham Pharmaceuticals, Sun Company, Inc., Temple University, Thomas Jefferson University, U.S. Steel – A Unit of USX Corporation. The OTS and the OSBA participated as active parties in this proceeding.

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Prehearing conferences were held on January 27, 1997, and March 4, 1997. Two public participation hearings were held on March 6, 1997, in Philadelphia. Seven days of hearings were held from March 10, 1997 through March 18, 1997, for the cross-examination of expert witnesses. Two additional public participation hearings were held on March 19, 1997, one in Media and one in Norristown.

The Administrative Law Judge's (ALJ) Recommended Decision was issued April 14, 1997. Whereupon, the following parties filed Exceptions: PECO, Senator Fumo, Environmentalists, CEPA, OCA, IP&L, and PAIEUG. Reply Exceptions were filed by the following parties: PECO, Senator Fumo, Environmentalists, CEPA, OCA, PAIEUG, OTS, OSBA, IP&L and Enron.

A. Procedural Matters[3]

1. Standing of Indianapolis Power and Light

PECO contends in its Reply Exceptions that IP&L lacks standing in its proceeding. PECO asserts that IP&L is not a "customer" and therefore, lacks the requisite direct, substantial and immediate interest to possess standing. The issue of standing should have been raised by PECO in its Exceptions and not in the Reply Exceptions. Procedurally, we conclude that PECO has waived its right to object to the ALJ's ruling.

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3. On April 14, 1997, Senator Fumo, CEPA, *et al.*, filed a Motion for Consolidation and Temporary Stay of Proceedings. Subsequently, on May 12, 1997, Senator Fumo, CEPA, *et al.*, filed an Application for Leave to Withdraw the Motion which has been considered and is, hereby, granted.

Furthermore, the Act requires this Commission to foster a competitive retail generation market. Therefore, any participant in this future market has a direct interest in the structure and rules of that market. As the owner of generation resources which it may sell in the Commonwealth, IP&L has a direct interest in this proceeding.

2. Allegheny Power Settlement

By Letter dated February 27, 1997, Allegheny Power submitted a Settlement Agreement between itself and PECO. The Settlement represents that Allegheny Power's primary concern with this proceeding was the intended use of the proceeds of the sale of the Intangible Transition Property (ITP). The Settlement also states that Allegheny Power is satisfied with the additional commitments made by PECO regarding the use of any proceeds. We find this Settlement Agreement to be reasonable and in the public interest and, as a result, it is approved.

III. Primary Recommendation

A. Expedited Qualified Rate Order Procedure

PECO requested an expedited review of its Application for a QRO[4] pursuant to Section 2812(b)(1)(i) of the Code, 66 Pa. C.S. §2812(b)(1)(i). PECO asserted that the aforecited Section of the Code expressly authorizes the issuance of a QRO in advance of the final approval of a utility's restructuring plan to facilitate the securitization of stranded costs. PECO's Application seeks to utilize Section 2812 of the Act to pass the

4. PECO seeks a QRO which will permit it to recover Qualified Transition Expenses totalling $3.773 billion.

benefits of securitization on to its customers at the earliest possible date. PECO anticipated that the net effect of the securitization process would be an annual rate reduction of approximately $111 million or about $1.1 billion over the next ten years. (PECO M.B., p. 1).

The ALJ's primary recommendation in this matter was to dismiss the filing and refer the entire matter to PECO's restructuring proceeding. (R.D., p. 17). In large part, the ALJ reached that determination based upon his theory that an expedited application for a QRO must limit itself to "uncontroversial" claims for stranded investment. In his discussion regarding PECO's Application, the ALJ stated that "Expedited QRO cases can only be completed in 120 days if the assets which are subject to the securitization are uncontroversial." (R.D., p. 17). The ALJ concluded that a fully litigated proceeding could not be concluded within that time frame given the number of standards. Accordingly, the ALJ determined that the Act could only have meant that an application for an expedited QRO must be "so clearly uncontroversial that it will allow review in the minimum time (120 days) permitted (and preferably, without a hearing)." (R.D., p. 11).

PECO filed an exception to the ALJ's determination that an expedited QRO must be limited to clearly uncontroversial assets. PECO asserts that a denial based upon the controversial nature of the claims at issue would "simply emasculate the statute." PECO contends that a rule that would require the Commission to side-step controversial issues would have the practical effect of conveying upon every intervenor veto power over a utility's securitization request. (PECO Exc., p. 9).

PECO also points out that although parties to this matter argued over various elements of the claim, not all parties contested the same elements or even agreed upon the adjustments advanced for a particular element. PECO suggests that given an issue of first impression under these circumstances, there is little hope of ever filing an application that would meet the ALJ's noncontroversial test. (PECO Exc., pp. 8-10).

PECO also argues that mere opposition to an issue does not require that the application be deferred in its entirety. Yet that is precisely what the ALJ would require, according to PECO. PECO asserts that it is up to the Commission to determine whether the alleged controversy is legitimate and, if so, whether interested parties have been provided an adequate opportunity to present their case. (PECO Exc., p. 10).

The Environmentalists responded by arguing, as the ALJ found, that the Act must have envisioned a noncontroversial application because of the brief time frame. They assert that the state of the record and the arguments now being made are clear indications that the Act envisioned a noncontroversial filing. (Environmentalist R.E., pp. 2-6).

In its Reply Exceptions, the OCA submits that the ALJ correctly determined that expedited securitization pursuant to the Act should be utilized for less controversial claims which can be known and measured with reasonable certainty, and whose recovery is reasonably assured under the Act. The OCA submits that it is the size, scope, complexity and significance of PECO's request, which, when adjudicated in such an expedited fashion, is not capable of a fair and proper resolution given the allegedly insufficient record produced. The OCA

urges the Commission not to make irrevocable decisions in this expedited proceeding, which could later prove unwise, given a more fully developed record, just to begin a securitization process a few months earlier than would otherwise be permitted. (OCA R.E., p. 8).

We reject, as unpersuasive, both the ALJ's recommendation and the parties' arguments which suggest a noncontroversial standard. PECO is correct in stating that such a standard renders impossible any expedited QRO filing. Controversy will exist over these matters. However, these matters are within the specific expertise of this Commission and we will fulfill our responsibilities under the Act.

We reiterate that nothing in the Act provides that an expedited QRO must limit itself to noncontroversial matters and we decline to graft such a requirement on the process here. The Act clearly states that applications for expedited securitization may be filed. Also, the Act does not limit the amount of securitization for which a utility may seek expedited review. Further, the Act plainly contemplates that there will be some contest in an expedited securitization proceeding. Section 2812(b)(1)(i) of the Act, 66 Pa. C.S. §2812(b)(1)(i), expressly provides for a determination of an expedited securitization application "[a]fter notice and an opportunity to be heard." Based upon the foregoing, we reject the ALJ's determination regarding a threshold requirement of "noncontroversial" stranded investment claims and grant PECO's Exception.

Senator Fumo, in his Exceptions, argues that the ALJ incorrectly implied that a QRO may be tendered prior to the Commission's consideration and evaluation of a utility's comprehensive restructuring plan. It is the position of Senator

Fumo that the implication of the Recommended Decision is contrary to the plain language of the Act's definition of "transition or stranded costs." Senator Fumo argues that, by definition, stranded costs may only be determined as part of a utility's restructuring plan. Senator Fumo asserts that it is clear that a utility may file an application for a QRO prior to its restructuring plan, but it does not necessarily follow that a utility may receive a QRO in advance of the Commission's consideration of a utility's comprehensive restructuring plan. (Senator Fumo Exc., p. 3). Senator Fumo also excepts to the ALJ's finding that the 120-day statutory period for review of PECO's QRO mandates a resolution during the 120-day time frame.

We disagree with Senator Fumo's argument that, by definition, stranded costs are only to be determined as part of a utility's restructuring plan. We find that this assertion is incongruent with the expressed language of the Act. Pursuant to Section 2812 of the Act, expedited requests for securitization must be decided within 120 days. This is the time frame approved by the General Assembly of Pennsylvania. We do not consider it within our purview to question the propriety of this time frame. Accordingly, the Exception of Senator Fumo regarding the propriety of the Expedited QRO review is denied.

B. PECO's Securitization Request and Mitigation Efforts

PECO asserted that the approval of its securitization proposal in this case would act to significantly mitigate its stranded costs. PECO added that the mitigation initiatives it has taken to date have enabled PECO to avoid filing for a general rate increase since 1989 and will save customers hundreds of millions of dollars in terms of avoided stranded

costs. Furthermore, PECO noted that its mitigation efforts were launched well before the Act became law, and not in response to it. (PECO M.B., pp. 58-59).

The ALJ found that PECO did not meet its burden of proving that it made a reasonable effort to mitigate its stranded or transition costs pursuant to Section 2806(c)(4)(i)-(vi) of the Act. (R.D., p. 16). The ALJ concluded, based upon his review, evaluation and analysis of the record that PECO failed to make a reasonable effort to mitigate its stranded costs in the totality of the circumstances. (R.D., p. 17).

PECO, by way of Exception, contends that the ALJ disregarded substantial record evidence, and misconstrued the requirements imposed by the Act. PECO contends that the ALJ's criticisms are clearly misplaced. PECO disagrees with the ALJ's interpretation of the Act contending that the various mitigation measures enumerated in Section 2808(c)(4) do not constitute affirmative obligations with which each electric utility must comply, but instead represents a list of examples. PECO points out that the term "list of examples" was a term actually used by the ALJ in his discussion of the issue. (PECO Exc., p. 12).

In its Reply Exceptions, the OCA argues that the ALJ raised many serious concerns regarding the timeliness and adequacy of PECO's mitigation efforts. The OCA urges the Commission to ensure that all parties have the right to thoroughly address this issue in PECO's restructuring proceeding where the timeliness and adequacy of PECO's mitigation efforts can be completely reviewed. (OCA R.E., p. 8).

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In their Reply Exceptions, the Environmentalists characterize PECO's actions as an effort to improve its profitability. The Environmentalists opine that PECO offers a circular view of mitigation wherein the securitization, which it must justify by proving it has mitigated, is itself a mitigation measure. (Environmentalists R.E., p. 7).

We interpret the provisions of Section 2808(c) of the Act as elements to be considered in setting a Competitive Transition Charge (CTC) and, by reference to Section 2808 within Section 2812, in ruling on a request for a QRO. We find that the failure of an electric utility to reasonably mitigate its stranded costs is not a reason, in and of itself, to dismiss a request for a QRO or a CTC. We are of the opinion that mitigation efforts may be considered in the process of determining the appropriate level of the QRO or CTC, but is not a threshold evidentiary standard for the establishment of a QRO or CTC.

Our reading of Section 2808 of the Act, leads us to conclude that the list of items contained in Section 2808(c)(4)(i)-(iv) of the Act are examples of mitigation expenses, and are not required actions pursuant to the Act. While PECO has undertaken some mitigation efforts, and no party has challenged its mitigation efforts to date, we believe that it is appropriate and in the public interest that this issue be further scrutinized in the restructuring proceeding.

Accordingly, we shall grant the Exception of PECO on this issue to the extent that it is consistent with the foregoing discussion. We shall reject the ALJ's finding and recommendation regarding PECO's mitigation efforts made pursuant to Section 2808(c)(4)(i) through (iv).

Appendix C

IV. Alternate Recommendation

A. Introduction

The ALJ made it clear that his primary recommendation in this matter is to deny PECO's request for an expedited QRO in its entirety, and to incorporate the record from this proceeding into the record of PECO's Application for Approval of its Restructuring Plan. Recognizing, however, that the Commission may not accept that recommendation, the ALJ provided an alternate recommendation. This alternative, if adopted, would grant PECO's request to the limited extent that it be permitted to securitize assets and issue transition bonds in the amount of $328.078 million.

A number of legal and technical issues have been raised by the various parties concerning the alternate recommendation.

B. Legal Issues

During the course of this proceeding, various parties raised issues regarding the burden of proof, the irrevocable nature of all or a portion of the QRO, the constitutionality of the Act and the process employed in this particular proceeding, antitrust implications, the Rate Cap provided in Section 2804 of the Act and the "regulatory compact" which PECO has asserted exists between itself and the Commonwealth of Pennsylvania. We will address these matters seriatim.

1. Requirements of the Act

a. Burden of Proof

As the proponent of its Application and the QRO sought therein, PECO is the party with the burden proof. 66 Pa. C.S.

§3332(a). Historically, a party which has the burden of proof before this Commission is required to carry that burden by proving its case by a preponderance of the evidence. *Samuel J. Lansbury, Inc. v. Pennsylvania Public Utility Commission*, 572 A.2d 600 (Pa. Commonwealth Ct. 1990), *petition for allowance of appeal denied* 529 Pa. 654, 602 A.2d 863 (1992); *See also North American Coal Corporation v. Air Pollution Commission*, 279 A.2d 356 (Pa. Commonwealth Ct. 1971) (burden of proof before administrative tribunals is the same as most civil proceedings, a preponderance of the evidence). A preponderance of the evidence means that one party has provided evidence which is more convincing, by even the smallest amount, than that submitted by its opponents. *Se-Ling Hosiery v. Margulies*, 364 Pa. 45, 70 A.2d 854 (1954).

Before the ALJ, several parties argued that PECO must be held to a higher standard of proof than a preponderance of the evidence. For example, Senator Fumo argued that PECO must demonstrate "a clear right to relief, free from all doubt, and further show that some irreparable immediate harm will result if such relief is not provided." (Fumo M.B., p. 22). CEPA argued that PECO "must demonstrate that it has clear right to relief, that the need for relief is immediate, that the applicant would suffer irreparable injury if not granted relief, and that the relief requested is not injurious to the public interest." (CEPA M.B., p. 5). PECO asserted that its burden is the historical preponderance of the evidence standard. (PECO Reply Memorandum of Law, p. 9).

At Page 18 of the Recommended Decision, the ALJ determined that PECO is required to prove its case by a preponderance of the credible evidence.

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The Environmentalists, and others, have excepted to the ALJ's determination that PECO's burden here is a preponderance of the evidence standard. The Environmentalists argue that an expedited QRO "is an extraordinary remedy, within the context of an extraordinary statute . . ." (Environmentalists Exc., p. 6). Based upon this view, the Environmentalists argue that PECO must meet its burden "with compelling evidence." (*Id.*). Similarly, Senator Fumo and CEPA argue that PECO must meet its burden by showing that it has a "clear right" to a QRO. (Fumo Exc., p. 5). (CEPA Exc., pp. 4-5). PECO responds that all three parties which filed exceptions on this issue misconstrue the nature of the Act's securitization provisions. (PECO R.E., pp. 4-5).

We have reviewed the Act in depth and can find no support for the conclusion that a higher burden of proof should be required in this action than has been historically demanded of a party before this Commission. Senator Fumo's and CEPA's arguments and authority are grounded in case law which addresses injunctive relief proceedings. Injunctive relief actions have historically imposed extremely high burdens of proof on parties seeking that form of remedy. Here, the Act provides particular standards which PECO must address in the course of its case, such as the "known and measurable" standard for stranded costs set forth in Section 2803 of the Act. However, the burden of proof by which PECO establishes those standards is a preponderance of the evidence as that term is defined by *Se-Ling Hosiery. Lansbury, supra.* We approach this issue with a focus on the fact that the potential irrevocability of the Commission's QRO compels us to be assured that the substantial record evidence is credible.

Therefore, the Exceptions of the Environmentalists, et al., on this issue are denied.

b. Standards

As we have noted above, PECO has the burden of proving, by a preponderance of the evidence, that the relief it seeks here should be awarded. In this matter, PECO must establish that its Application for securitization of $3.77 billion of expenses is warranted. In reviewing PECO's Application, we must ensure that our findings and determinations are supported by substantial evidence of record.

We are mindful as we review PECO's Application that we are also making a determination that a portion of PECO's asserted stranded investment qualifies for recovery as stranded or transition costs as those terms are defined in the Act. Accordingly, we are guided by the Act's standards which provide that any amount of stranded investment that is allowed for recovery must be (1) known and measurable; (2) calculated at the net present value; (3) just and reasonable; and (4) in the public interest. 66 Pa. C.S. §§2804, 2812.

The term "just and reasonable" has been a guidepost in traditional ratemaking. The Pennsylvania Supreme Court has stated:

> the term "just and reasonable" was not intended to confine the ambit of regulatory discretion to an absolute or mathematical formulation but rather to confer upon the regulatory body the power to make and apply policy concerning the appropriate balance between prices charged to utility consumers and returns on capital to utility investors consonant with constitutional protections applicable to both.

Pennsylvania Public Utility Commission v. Pennsylvania Gas and Water Co., 492 Pa. 326, 337; 424 A.2d 1213, 1219 (1980),

certiori denied 454 U.S. 824, 102 S.Ct. 112, 70 L.Ed.2d 97. In the context of the Act, we deem the essence of "just and reasonable" to require the balancing of the interests of shareholders, ratepayers, and new entrants to the market as we move to a competitive electric generation market. Similarly, as we approach this proceeding with a view to the "public interest," the "public" includes the ratepayers, the utility and its shareholders as well as participants in the emerging electric generation market.

In its Application, PECO has requested that any QRO which is issued in this proceeding be declared to be irrevocable, (Application, ¶ 23, p. 14). The Act expressly provides for our authority to provide that all, or a portion, of a QRO shall be irrevocable:

> Notwithstanding any other provision of law, the Commission has the power to specify that all or a portion of a Qualified Rate Order shall be irrevocable. To the extent so specified, neither the order nor the intangible transition charges authorized to be imposed and collected under the order shall be subject to reduction, postponement, impairment or termination by any subsequent action of the Commission. Nothing in this paragraph is intended to supersede the right of any party to judicial review of the Qualified Rate Order.

66 Pa. C.S. §2812(b)(3).

The determination of whether to provide that all or a portion of a QRO is irrevocable is to be made separately from the determination of whether to grant the QRO in the first instance.

66 Pa. C.S. §2812(b)(3). Although the Act does not expressly provide standards for approval of irrevocable status within that Section, we find that this determination should be made based upon a just and reasonable standard and whether, based upon all the evidence, a grant of irrevocable status is in the public interest. See 66 Pa. C.S. §§1301, 2812.

In making the determination of whether or not approval of irrevocable status is just and reasonable and in the public interest, we must determine whether such a grant will produce net benefits, considering the risks, over a revocable QRO. This determination must be made from the perspective of the ratepayers who will be obligated to finance the full costs of such bonds. As we have noted, PECO must establish that irrevocable status is warranted by a preponderance of the evidence and our determination must be supported by substantial evidence. *Lansbury*. Our determination of the irrevocable status of the QRO and the evidentiary discussion of that determination is provided *infra*.

2. Constitutional Issues

a. Statute

Various parties in this proceeding (e.g. CEPA, Senator Fumo, the Environmentalists) have raised issues regarding the constitutionality of the statute and the manner of its enactment. PECO asserted that this Commission does not have authority to make constitutional determinations relating to our governing statute. The ALJ agreed with PECO and declined to rule on these constitutional issues. The Environmentalists filed Exceptions relating to the constitutionality of the statute, but generally agreed with the ALJ's position. (Environmentalist Exc., pp. 10-12).

Appendix C

In *Borough of Green Tree v. Board of Property Assessments*, 459 Pa. 262, 328 A.2d 819 (1974), the Pennsylvania Supreme Court stated:

> Our opinions in the past have generally shown an awareness that the more direct the attack on the statute, the more likely it is that exercise of equitable jurisdiction will not damage the role of the administrative agency charged with enforcement of the act, nor require, for informed adjudication, the factual fabric which might develop at the agency level. The reason, we believe, is that the determination of the constitutionality of enabling legislation is not a function of the administrative agencies thus enabled. *See Philadelphia Life Insurance Company v. Commonwealth*, 410 Pa. 571, 190 A.2d 111 (1963). The more clearly it appears that the question raised goes directly to the statute the less need exists for the agency involved to throw light on the issue through exercise of its specialized fact-finding function or application of its administrative expertise.

(459 Pa. at 291; 328 A.2d at 825).

Based upon the foregoing, we affirm the ALJ's ruling and will not rule on the constitutional challenges to the statute based upon allegations regarding its enactment or its provisions regarding the ability of this Commission to provide for an irrevocable QRO. With regard to our determination of the irrevocable nature of the QRO, we will apply the standards of the Act as set forth above.[5]

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5. We note that both PECO and the Environmentalists cite to *United States v. Winstar Corp.*, 116 S.Ct. 2432 (1996), in support of arguments

(Cont'd)

Therefore, the Exceptions of Senator Fumo, et al., on this issue are denied.

b. Due Process

Several of the parties argued that the process involved in this matter was so abbreviated as to violate the parties' rights to due process. For example, the Environmentalists argued that although hearings were provided, they were denied the benefit of hearings due to the compressed time schedule. (Environmentalists M.B., pp. 52-53). The ALJ agreed with the Environmentalists with regard to the compressed time frame. (R.D., p. 17).

The Environmentalists filed Exceptions to the ALJ's alternative recommendation and reiterate, almost verbatim, their briefing position on the procedure in this proceeding. (Environmentalists Exc., pp. 7-9). PECO excepted to the ALJ's primary recommendation, asserting that the time frame was established by the Act. PECO argued that the parties conducted extensive discovery, submitted testimony and exhibits and had seven hearing days in which to cross examine PECO's witnesses. PECO also noted that four separate days of public

(Cont'd)

in this matter. The Environmentalists argue that *Winstar* provides that an irrevocable QRO would bind future General Assemblies and, therefore, violates the Pennsylvania Constitution. Article II, Section 1 (relating to powers of the General Assembly). (Environmentalists Exc., pp. 11-12). PECO argues that *Winstar* requires recognition of a "regulatory compact" and recovery of stranded investment. (PECO M.B., pp. 16-10. PECO R.E., pp. 10-11). As noted in this Opinion and Order, we will not determine constitutional challenges here, nor is it necessary to resolve PECO's regulatory compact arguments in the context of this proceeding.

input hearings were provided. (PECO Exc., pp. 4-5). In view of the discovery and actual hearing opportunities, PECO argues that due process has been observed in the context of this proceeding.

As PECO points out, the time frame within which to decide this matter is provided in the Act: 120 days. 66 Pa. C.S. §2812(b)(1)(i). Also, there is no dispute that both evidentiary and public input hearings were provided in this matter.[6] In *Barasch v. Pennsylvania Public Utility Commission*, 546 A.2d 1296 (Pa. Commonwealth Ct. 1988), *petition for allowance of appeal denied* 523 Pa. 652, 567 A.2d 655 (1989), the Pennsylvania Commonwealth Court provided an extensive discussion of procedural due process requirements in Commission proceedings. In that case, the Commonwealth Court followed *Conestoga National Bank of Lancaster v. Patterson*, 442 Pa. 289, 275 A.2d 6 (1971), and provided that due process is required in administrative actions which are adjudicatory in nature and involve substantial property rights. In the case before us, we agree with the Environmentalists that the matter is adjudicative in nature. To a limited extent, we also note that the ratepayers of PECO have substantial property rights at issue analogous to the Commonwealth Court's analysis of the ratepayer rights in *Barasch*. 546 A.2d at 1305. Although this case represents the determination of a rate *decrease*, it does involve the securitization of assets which PECO's ratepayers will be obligated to fund.

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6. The Environmentalists make the argument that PECO's notice of its Application was deficient. (Environmentalists Exc., p. 9). However, as noted by PECO, the Environmentalists received actual notice of these proceedings and fully participated therein. Accordingly, they lack standing to raise this issue. *Barasch v. Public Utility Commission*, 546 A.2d 1296, 1302, n. 7 (Pa. Commonwealth Ct. 1988). In any event, PECO clearly provided notice as required.

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Having determined that this proceeding is adjudicatory in nature and does involve substantial property interests, what then does due process require? "[T]he essential elements of due process are notice of governmental action and an opportunity to be heard to challenge that action, although the timing of provision of these safeguards may vary depending on the circumstances." *Barasch*, 546 A.2d at 1305. Our review of the schedule of this proceeding, and the evidence adduced at hearing, leads us to conclude that the parties were afforded adequate notice and a *meaningful* opportunity to be heard at an appropriate stage of the proceeding. A meaningful opportunity to be heard includes reasonable examination and cross examination. *AT&T Communications of Pennsylvania, Inc. v. Pennsylvania Public Utility Commission*, 570 A.2d 613 (Pa. Commonwealth Ct. 1990).

There is no doubt that the 120 day time schedule provided by the Act required that all parties exercise diligence in the conduct of their respective cases. That, however, is not to say that four months was too brief a period to permit meaningful record development. We agree with PECO that the process in this case, which provided for extensive discovery and seven days of evidentiary hearings, as well as four separate days of public input hearings, provided the requisite due process protections. Our review of the schedule and the record in this matter leads us to conclude that all parties were provided with adequate notice and a reasonable opportunity to appear and be heard on the issues in this case. As we will discuss below with regard to specific elements of this case, we find that the record as developed in this proceeding is more than sufficient to enable us to reach deliberate and reasoned determinations of these issues.

Accordingly, we will deny the Exceptions of the Environmentalists relating to due process and grant the Exceptions of PECO on this issue.

3. Antitrust and Commerce Clause Issues

The Environmentalists argued before the ALJ that the requested relief "may" violate state common law of antitrust and federal antitrust law. (Environmentalists M.B., pp. 53-54). This statement is footnoted with citations to several antitrust cases at the state and federal level. No other argument is made. The ALJ did not address this issue in his Recommended Decision.

In their Exceptions, the Environmentalists repeat, verbatim, the single footnoted sentence which was in their Main Brief. (Environmentalists Exc., pp. 13-14). PECO responds by noting that there is nothing in the record to support a conclusion that there is a violation of state or federal antitrust provisions. (PECO R.E., pp. 17-18).

As was discussed above in the Section relating to burden of proof, our determinations in this proceeding must be supported by substantial evidence and the part advancing a particular proposition must prevail by a preponderance of the evidence. *Lansbury*, *supra*. The basic premise of both those standards requires that some evidence be present on the record. The Environmentalists have not provided even a hint of the factual basis upon which they base their claim of antitrust concerns. Accordingly, their Exception relating to antitrust issues is denied.

Appendix C

The Environmentalists argued before the ALJ that CTC and ITC recovery violates the Commerce Clause of the United States Constitution. Although the ALJ did not address these arguments, we find that they must fail for the same reasons as the Environmentalists' argument relating to antitrust. There is simply no factual basis upon which to make such a determination. We also note in this context that the Act is expressly designed to bring competition for the electric generation market *into* the Commonwealth. 66 Pa. C.S. §2802. Therefore, the Exception of the Environmentalists on this issue is denied.

4. Extended Rate Cap

The OCA and PAIEUG argued before the ALJ that in the event securitization is approved in this proceeding, which will result a non-bypassable ITC charge on customers bills for a minimum of 10 years,[7] then the rate cap for electric generation set forth in Section 2804(4) of the Act, 66 Pa. C.S. §2804(4), should be extended to correspond for the length of the ITC charges. (OCA M.B., pp. 55-56; PAIEUG M.B., pp. 55-56). Both the OCA and PAIEUG argued the Act contemplates that both the recovery of stranded cost and the generation related rate cap are expected to last for nine years. 66 Pa. C.S. §§2808(b) and 2808(4). Accordingly, the OCA and PAIEUG argued before the ALJ that if the ITC will last longer than the 9 years anticipated in Section 2808(b), then the generation rate cap must also be extended for a similar time period.

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7. PECO has proposed to amortize the recovery of the costs associated with the issuance of transition bonds over a ten year period. PECO has also requested a 2 year window within which to issue the bonds. Accordingly, it is conceivable that, if all of the requests are granted, PECO's recovery period could extend up to 12 years beyond approval of the QRO.

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The ALJ found that the rate cap provided in the Act could not be extended by this Commission. (R.D., p. 76). The ALJ quoted Section 2808(4)(ii) and found that the Act provided that the cap will last a maximum of 9 years, even if the ITC recovery is for a longer period of time, although the cap may be shorter if the ITC concludes sooner than the 9 year time frame. (*Id.*).

The OCA, PAIEUG and the Environmentalists filed Exceptions to this issue. The OCA argues that when the rate cap provision of Section 2808(4) is read in conjunction with the provisions of Section 2808(b), which provides authority to extend the collection of the stranded or transition cost recovery, then it is clear that we may extend the rate cap. The OCA asserts that by seeking an ITC which extends 10 years or longer, PECO has implicitly requested that we waive the 9-year rate cap time period. In addition, according to the OCA, nothing in either Section 2808(b) or Section 2808(4) of the Act prohibits this Commission from finding that extension of the rate cap is a necessary condition for approval of an extended recovery period for stranded or transition costs. Absent an extension of the rate cap, the OCA argues that PECO's requested extended recovery period should be denied. (OCA Exc., pp. 4-5).

Similar to the OCA, PAIEUG argues in its Exceptions that the ALJ's reading of the Act is overly restrictive. Like the OCA, PAIEUG asserts that Section 2808(b) and Section 2808(4) must be read in conjunction. Further, according to PAIEUG, the public interest standard in Section 2812(a)(2)(iii) provides authority for extension of the rate cap under these circumstances. (PAIEUG Exc., pp. 4-6). The Environmentalists join the OCA and PAIEUG and argue that there is no explicit prohibition against a voluntary rate cap extension as a condition to the approval of an extended recovery period for the transition and stranded costs. (Environmentalists Exc., pp. 20-21.).

PECO asserts that the ALJ was correct in his statutory analysis. In addition, PECO asserts that there is no record support for the assertion of the OCA and PAIEUG that ratepayers will be harmed in the event the rate cap is not extended to match recovery of stranded and transition costs. (PECO R.E., pp. 8-10).

We will deny the Exceptions of the OCA, PAIEUG and the Environmentalists on this issue. As noted by PECO, the rate cap provision in Section 2808(4) stands on its own. That Section provides that the rate cap will be in existence for 9 years or until the ITC is completed, whichever is shorter. (PECO R.E., pp. 6-7). However, the concerns regarding the time frames for recovery of stranded costs and transition costs through an ITC and its relationship to the rate cap are well founded. As we will discuss below with regard to PECO's requested two year window for the issuance of the transition bonds, we will authorize transition bond issuance for a twelve month period. We will encourage PECO to issue bonds with a maturity date of December 31, 2005, but in no event should the bonds contain a maturity date beyond 10 years from the date of issuance.

In the event any bond has a maturity date beyond December 31, 2005, the Commission's strong expectation is that, in a competitive market for electric power, the utility will not exceed the rate cap for the remainder of the collection period of the ITC. If it appears that the utility proposes to exceed the rate cap, then we shall consider all possible remedies to alleviate the situation, including but not limited to our authority under Section 2806 of the Act (relating to performance based rates) and Section 2811 of the Act (relating to market power remediation). PECO and the OCA have jointly proposed

specific language for the QRO which addresses, in part, the rate cap set forth in Section 2804 and the period of ITC collection. We will incorporate that language into the QRO which will issue here.

5. Regulatory Compact

Before the ALJ, PECO argued that denial of stranded cost recovery would effect a breach of the Commonwealth's obligations under a "regulatory compact" with PECO and constitute a deprivation of PECO's property "for which the Commonwealth would be liable under long-standing contractual and constitutional principles." (PECO M.B., p. 16). (footnote omitted). The OCA, CEPA, Senator Fumo and PAIEUG argued that there was no regulatory compact. (CEPA M.B., pp. 18-25; Senator Fumo M.B., pp. 26-29, OCA R.M., pp. 4-21; PAIEUG R.M., pp. 2-16).

The ALJ discussed PECO's argument and determined that although the Act provides an opportunity to request 100% recovery of stranded costs, there is no guarantee of a 100% recovery. (R.D., pp. 76-77). The ALJ found that to the extent that there are any constitutional ramifications flowing from the regulatory compact issue, they would not be resolved by this Commission. The ALJ also determined that the parties' concerns about a regulatory compact were misguided. The ALJ stated that the Act now governs issues surrounding stranded investment recovery. (*Id.*).

CEPA filed an Exception arguing that the ALJ must be reversed to the extent there is any implication that a regulatory compact exists. CEPA asserts that there must be a clear declaration that no regulatory compact exists which would

justify the recovery of stranded investment. (CEPA Exc., pp. 5-6). In its Reply Exceptions, PECO reiterated its position advanced before the ALJ. PECO asserts that a regulatory compact exists and has been recognized by this Commission and the courts. Pursuant to that regulatory compact, to the extent that the Act alters the relationship between PECO, this Commission and the public such that PECO will have stranded investment as a result. PECO argues that the stranded investment must be recovered, citing to *United States v. Winstar Corp.*, 116 S.Ct. 2432 (1996). (PECO R.E., pp. 10-11; PECO M.B., p. 16).

This proceeding involves PECO's Application for a QRO authorizing securitization of a *portion* of those assets and costs which PECO asserts constitute stranded and transition costs as defined in Section 2803 of the Act. Pursuant to 66 Pa. C.S. §2812(b)(1)(i), "all remaining amounts and amounts not resolved by the commission shall be deferred for consideration in a final order regarding the utility's restructuring plan under section 2806." Because we are only addressing a portion of PECO's stranded investment claim in this proceeding, we find it unnecessary to address the parties' arguments regarding the existence of a regulatory compact in the first instance, and, secondly, whether such a compact would operate to guarantee 100% recovery independent of the Act.

Accordingly, we will deny CEPA's Exception on this issue for purposes of this expedited QRO proceeding. Our determination here preserves the opportunity for all parties to raise this issue in the context of PECO's restructuring filing, if they so desire.

Appendix C

C. Stranded Generation Assets

PECO's early securitization claim regarding generation assets was $2.435 billion. This claim was approximately 68.28% of PECO's net stranded plant which was quantified to be $3.566 billion. To establish the net stranded plant of $3.566 billion, the Company used estimated market electricity price forecasts presented by EDS, ICF Resources, and Putnam, Hayes and Bartlet (PHB).[8] (PECO Exh. No. TPH-14 (Rebuttal)). PECO submitted the results of the three separate market valuation analyses in the expectation that we would accept, as reasonable bounds of future market expectations, a range of values, any one of which was more than sufficient to support the Company's requested rate reduction. (PECO M.B., p. 39). A more detailed explanation of PECO's analyses of market value is found on page 21 of the R.D.

We believe that it will be instructive at this juncture to summarize the positions of the parties on this issue. The OTS presented three adjustments to the PECO's revised December 31, 1998, stranded generation plant claim of $3.566 billion (Exh. No. TPH-14) and advocated an allowance of $1.6 billion. The three adjustments were: price sensitivity, ($812 million), audit adjustment ($800 million) and rate of return ($360 million). (OTS Exh. No. SR-1A, Sch. 3).

The OCA argued that the Company had not demonstrated the level of its generation-related stranded cost with sufficient certainty to warrant an irrevocable ratepayer commitment to securitize these costs. The OCA noted that the Act required such costs to be found just and reasonable. The OCA further

8. These studies will be henceforth referred to as the EDS, ICF and PHB studies.

contended that the determination of a "just and reasonable" level of recovery of generation assets was a highly controversial matter that should be considered in the Company's restructuring proceeding. (OCA M.B., p. 28).

The OSBA witness observed, based upon Company provided sensitivity analyses from the ICF model, that "PECO appears to have a greater potential for upside gain than downside loss in connection with a given market price change." (OSBA M.B., p. 16). Based on its analysis, the OSBA recommended that the Commission refrain from approving PECO's request for early and irrevocable securitization of a portion of generation plant. (OSBA M.B., p. 33).

PAIEUG asserted that PECO's approach to market price forecasts suffered from the following four flaws and should be rejected: (1) PECO assumed that market prices would equal marginal costs; (2) PECO's forecasts presented widely divergent and hence unreliable results; (3) PECO's forecasts utilized different fuel price projections and, (4) PECO's forecasts failed to adequately reflect long run marginal cost. (PAIEUG M.B., p. 20). Because of these flaws, and because of the other problems common to all three PECO studies, PAIEUG concluded that stranded costs of no more than $607 million should be considered for securitization related to generation assets. (PAIEUG M.B., pp. 19-20).

Enron supported proposals for securitization of only that portion of PECO's claim which had been shown to meet the standards in the statute and were sufficiently known and certain as to permit their recovery outside the context of PECO's restructuring proceeding. Enron was of the opinion that the proposal put forth by the OCA appeared to satisfy these requirements. (Enron M.B., p. 9).

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IP&L took the position that PECO's entire case was unsubstantiated. IP&L maintained that all "revenues" were mere estimates, and all "costs" were mere projections. IP&L concluded that the appropriate conclusion was denial of all relief, with guidance provided to PECO on how future presentation of these issues should proceed. (IP&L M.B., p. 46).

The Environmentalists argued that PECO's analysis of the generation-related stranded costs was full of uncertainty, questionable assumptions and wild guesses. The Environmentalists concluded that the Commission could not rest an "irrevocable" decision on such a problematic case. (Environmentalists M.B., pp. 45-46).

CEPA is opposed to the method that PECO adopted for calculating the present value of its stranded generation plant costs because it rested on unproven and unprovable assumptions about electricity prices in an unregulated market in the distant future. CEPA further asserted that a valuation of the present value of stranded generation plant which rested solely on such assumptions was not "known and measurable" within the meaning of the Act. (CEPA M.B., p. 13). For these and other reasons, CEPA concluded that PECO's Application for issuance of a QRO should be rejected. (CEPA M.B., p. 44).

Senator Fumo argued that the Legislature intended to include the phrase "known and measurable" in order to ensure certainty in the Commission's decision, and to prevent utilities from inadvertently obtaining a windfall based on speculative costs. According to Senator Fumo, the evidence provided by PECO ignored this clear legislative concern. (Senator Fumo M.B., pp. 33-34). Regarding PECO's claim, Senator Fumo

recommended that the Commission deny PECO's request for a QRO and defer further consideration as part of the utility's comprehensive restructuring filing. (Senator Fumo M.B., p. 46).

It is the position of PP&L that the determination of a utility's stranded costs and the way those costs were to be translated into rates was among the most fact intensive and complex of the myriad issues raised by the restructuring of the electric utility industry. Because of this complexity and the expedited nature of this proceeding, PP&L advocated that the Commission should approve only those Qualified Transition Expenses (QTE) that were beyond controversy and defer consideration on the remaining amount to the restructuring proceedings. (PP&L M.B., p. 13).

The ALJ noted that the methodologies employed by PECO in this proceeding to quantify its claimed level of stranded generation assets have received only criticism. The ALJ also noted that two of the parties commenting on PECO's claim offered alternative positions. The OTS presented $1.6 billion as a minimum amount for PECO's stranded generation assets claim. (OTS M.B., p. 30). PAIEUG suggested $607 million. (PAIEUG M.B., p. 19).

The ALJ also asserted that the market studies presented were complex, inconsistent, novel and untested and, therefore, lacked credibility. The ALJ further contended that the short time frame of this proceeding did not give parties the opportunity to perform detailed and in-depth analysis of each market analysis, nor did any party have ample time to prepare and present their own studies to support an appropriate, substitute net value. In addition, noted the ALJ, while PECO's generation plant was used to serve both retail and wholesale

customers, PECO only allocated its claim to retail jurisdictional customers. This failure to allocate any portion of its assets to the wholesale market further undermined the value of PECO's case. (R.D., pp. 27-28).

The ALJ recommended that we reject the OTS' recommendation and PAIEUG's proposed level of stranded generation plant as too speculative. The ALJ further recommended that PECO's $2.435 billion claim for net stranded generation plant be denied, and deferred for consideration to the Company's restructuring proceeding. (R.D., pp. 27-28).

PECO excepts to the ALJ's recommendation. PECO agrees that the modeling of future sales of energy and capacity in an evolving deregulated market is a complex and novel undertaking. However, PECO asserts that neither the complexity nor the newness of the undertaking impugns its credibility nor that of its expert witnesses. PECO contends that the ALJ's finding that PECO's experts produced results which were "inconsistent" and "at odds with one another" (R.D., p. 18) is erroneous. PECO retorts that the fact that its three models produced somewhat different results is not the result of "inconsistencies" but rather the result of legitimate and independent differences in modeling techniques and input assumptions.

PECO argues that it is not, in this proceeding, asking that the Commission pick a specific market price estimate that could later be construed as tying the Commission's hands in the Company's future restructuring proceeding. Rather, PECO asserts that in submitting the results of three separate market valuation analyses, the Company's intention was to provide the Commission with a range of values. PECO avers that the

results of any one of these market valuation analyses would be more than sufficient to support the securitization of its claimed amount ($2.4 billion out of $3.6 billion of total stranded generating plant costs). PECO maintains that its projections set forth reasonable bounds of future market expectations and, at a minimum, should be accepted for that limited purpose. (PECO Ex., pp. 12-14).

In its Reply Exceptions, the OCA argues that the ALJ correctly recommended rejection of PECO's requested recovery of $2.4 billion of its estimated $3.5 billion of stranded generating assets based on the uncertainty of PECO's estimate of its stranded cost. The OCA submits that particularly for utility-owned generating plant, the Commission must determine a level of stranded cost recovery that is just and reasonable. Section 2808(c)(3) of the Code, 66 Pa. C.S. §2808(c)(3). It is the contention of the OCA that an expedited proceeding such as this does not allow for the development of an appropriate record upon which to base such a determination. Accordingly, contends the OCA, the ALJ has correctly recommended that PECO's claim be deferred to its restructuring proceeding. (OCA R.E., pp. 9-11).

In its Reply Exceptions, the OSBA asserts that many of the key assumptions underlying PECO's market valuation models may be incorrect. If altered, contends the OSBA, those factors can cause such enormous swings in PECO's market valuation estimates as to raise serious concerns relating to their reliability and usefulness. (OSBA St. No. 1 at 1-14). In particular, the OSBA argues that a fundamental flaw in PECO's presentation of its total stranded cost claim was its failure to subject the results of its market price models to the necessary sensitivity analyses. (OSBA R.E., pp. 3-9).

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In its Reply Exceptions, PAIEUG asserts that PECO's Exception on the issue of stranded generation assets must be denied for at least three reasons. First, PAIEUG asserts that with respect to its pricing models, PECO confuses novelty and complexity with inaccuracy and unreliability. Second. PECO's claim that the disparate results achieved by its three studies are a strength reflective of legitimate differences is absurd.[9] Third, PAIEUG contends that PECO incorrectly claims that its studies were or could have been tested and analyzed. PAIEUG avers that PECO's market price studies are inherently flawed and unreliable, and that the disparity of the results achieved by the studies amply illustrates the weakness and lack of reliability of the studies. (PAIEUG R.E., pp. 4-7).

In their Reply Exceptions, the Environmentalists argue that PECO's Exception on this issue should be denied because there is in the record ample expert testimony to warrant the ALJ's conclusion that the three studies proffered by PECO were "complex, inconsistent, novel and untested." The Environmentalists contend that PECO could have ameliorated the time constraints. The Environmentalists argue that PECO's failure to waive the 120-day schedule indicates that the Company freely and deliberately chose to offer such complex testimony, using models never before reviewed by the Commission, within the constraints of the 120-day schedule. Accordingly, asserts the Environmentalists, PECO's Exception on this issue should be denied. (Environmentalists R.E., pp. 8-10).

The key to the resolution of this issue lies in the credibility of the market studies relied upon by PECO to support its claim

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9. PAIEUG notes in this regard that the operative statute requires that transition or stranded costs be "known and measurable." Section 2803 of the Public Utility Code, 66 Pa. C.S. §2803.

in this issue.[10] The question is, do we know enough, at this point in time, to conclude that these market value studies or models produce accurate results? If the answer to this question is in the negative, then no relief should be granted because the "known and measurable" standard cannot be met. If, however, we do have some level of confidence with regard to the credibility of the studies, then we must delve deeper to find the level of allowance for this claim that is the most reliable at this time.

As we have detailed in the positions of the parties outlined *supra*, the intervenors herein, especially the OCA and PAIEUG, made numerous factual challenges to the assumptions that were at the base of PECO's market price studies and its stranded generating claim. While we are of the opinion that not all of these evidentiary challenges are meritorious, we conclude that, on balance, PECO has not yet met its burden of proof that its stranded generating plant claim of $2.435 billion is known and measurable, just and reasonable, and in the public interest.

In our opinion, PAIEUG submitted the most comprehensive evidentiary challenge to PECO's stranded generating plant claim, recommending that $1.828 billion of the amount proposed by PECO be denied, and that approximately

10. As noted *supra*, the three market price studies relied on by PECO were the EDS, ICF, and PHB studies. These studies used computer modeling to predict the future market price for generation over the forecast period. The EDS, ICF, and PHB studies respectively predict a 1999 market price of 2.92, 2.77, and 2.42 cents per kilowatt-hour and net stranded generating plant owned by PECO of $3.33 billion, $3.47 billion, and $3.89 billion. An average of its three market price studies produces a 2.70 cents per kilowatt-hour. For a fuller discussion of the general methodology for estimating stranded generation assets, see PECO Main Brief, pp 38-39.

$607 billion be approved for securitization. Among the specific adjustments proposed by PAIEUG were the following: (1) using nuclear capacity based on 1992-1996 actual data; (2) using a 7.77% after tax discount rate; (3) using an estimated long run marginal cost of generation based on base load combined-cycle plant; (4) changing the EDS assumption of no inflation increases to the cost of new capacity; and (5) omission of the shut-down Salem nuclear plant.

After careful scrutiny of the record herein, including a consideration of the positions of the parties, we are persuaded that the evidence herein warrants securitizing $607.355 million of PECO's generation plant stranded investment, as recommended by PAIEUG. We reach this conclusion because we are persuaded that the adjustments proposed by PAIEUG raise substantial questions that would make it unreasonable and unjust, and not in the public interest, at this time, to approve PECO's total claim of $2.435 billion for stranded generation assets. We are further persuaded that the adjustments as proposed by PAIEUG are just and reasonable and in the public interest. We further reach this conclusion mindful of the irrevocable nature of a QRO. Our conclusion today allows PECO to securitize sixteen percent (16%) of its stranded generation claim. PECO's request to securitize the remaining amount of generation plant is deferred without prejudice to their restructuring proceeding at Docket No. R-00973953. PECO's Exception on this issue is, therefore, denied.

D. Regulatory Assets

As of December 31, 1998, PECO will have recorded on its balance sheet generation-related regulatory assets and deferred fuel costs totaling $2.633 billion. (PECO St. 2, p. 15; R.D.,

p. 28). These regulatory assets are defined by the Statement of Financial Accounting Standards No. 71, Accounting for the Effects of Certain Types of Regulation, as a cost allowable in a period other than the period in which the cost could be charged to expense by an unregulated enterprise. (PECO St. 2, p. 14).

1. Recommended Allowance

PECO requested authority to securitize a total of $1.2 billion of its generation-related regulatory assets and deferred fuel costs which it considered stranded. (PECO Exh. No. TPH-6). PECO divided its regulatory asset claim for securitization into eight items, as summarized here and more fully discussed below. (SFAS 109 is discussed in Item 2 of Section D).

	Million
50% of Common Plant of Limerick	$ 77.927
50% of Common Plant of Eddystone, Peach Bottom and Salem	6.819
Early Window Costs for Limerick 1	14.097
Early Window Costs for Limerick 2	30.134
Deferred Fuel Costs	239.462
Unamortized Loss on Reacquired Debt	75.001
SFAS No. 106	45.852
SFAS No. 109	675.550

The OCA identified four regulatory assets totaling $514 million which it considered to be reasonable candidates for securitization in this proceeding and which would result in rate savings of approximately $19 million. (OCA M.B., pp. 15-18. R.D., p. 30). The OCA maintained that the savings also reflected

the inclusion of the deferred fuel costs which were not previously reflected in rates. (OCA M.B., p. 18; R.D., p. 30).

PAIEUG recommended that PECO be permitted to securitize $629 million of regulatory assets in this proceeding, and the remaining amount be deferred to PECO's restructuring proceeding. (PAIEUG M.B., pp. 33, 34 and 57).

a. Carrying Charge on 50% of Limerick Common Plant

Limerick Station is a two unit generating station that utilizes common facilities. In 1996, the Commission directed PECO to defer the carrying charges and depreciation expense associated with the common plant that was in service, but not included in rate base. In 1990, the Commission allowed PECO to amortize the deferred costs over the life of Limerick 2 with a return on the unamortized balance. PECO requested that $77.927 million of this regulatory asset be securitized at this time. (R.D., p. 31).

The OCA recommended that PECO be permitted to securitize the unamortized balance at December 31, 1997, of $201.8 million. (OCA M.B., p. 17; Exh. No. RLC-2 Rev., p. 5). This cost was already reflected in rates and securitization would result in savings initially and over the remaining amortization period. (OCA M.B., p. 17). These carrying charges were not included in PAIEUG's recommendation for securitization in this proceeding. (PAIEUG St. No. 3, p. 8).

b. Carrying Charge on 50% of Common Plant of Eddystone, Peach Bottom, and Salem

These carrying charges arise from the Commission policy which allows only 50% of common plant in a utility's rate base

for ratemaking purposes when the first unit of a multi-unit plant is placed in service. (PECO St. No. 2, p. 16). PECO requested that $6.8 million of the carrying charges be securitized at this time. (PECO Exh. No. TPH-6).

The OCA argued that the $18.3 million of deferred common facility costs on 50% of the Eddystone, Peach Bottom and Salem Stations, which was reflected as carrying charges and included in rates, was a reasonable candidate for securitization and would result in savings to ratepayers. (OCA M.B., p. 18, OCA Exh. No. RLC-2 Rev., p. 4). PAIEUG did not include these costs in its list of items to be securitized at this time. (PAIEUG St. No. 3, p. 8).

c. Limerick 1 and 2 Early Window Costs

The Limerick 1 and 2 Early Window Costs were deferred costs incurred by PECO from the time these units entered commercial operation until they were reflected in rates. (OCA M.B., p. 19).

PAIEUG recommended that the Limerick 1 and 2 early window claims be included in the stranded cost calculation, at a total of $68.2 million, to reflect the present value at December 31, 1998, of PECO's future recovery under the current level of base rates. (PAIEUG M.B., pp. 47-48; PAIEUG St. No. 3, p. 8).

The OCA recommended excluding the Limerick 1 early window costs from PECO's securitization claim and deferring Limerick 2 early window costs to PECO's restructuring proceeding. (OCA M.B., pp. 20-21). The OCA noted that there was no return or interest on early window costs, so securitizing

Limerick 1 early window costs would impose additional interest and would result in no savings to customers. (OCA M.B., p. 20).

d. Deferred Fuel

PECO's claim for securitization of deferred fuel costs totaled $239 million. This included $96 million for actual undercollected energy costs from February 1, 1996, to December 31, 1996, an earned nuclear performance bonus for calendar year 1996, and associated interest. The $143 million balance is the projected undercollections of energy costs. (PECO M.B., p. 315). PAIEUG and the OCA agreed that $92 million of the deferred fuel costs should be included in PECO's securitization claim. The OCA further agreed that PECO should also include the interest expense. (PAIEUG M.B., p. 46; OCA M.B., pp. 15-17.

e. Unamortized Loss on Reacquired Debt

PECO asserted that, to encourage prudent refinancing of high coupon debt, the Commission permitted utilities a return of and a return on such premiums. The Company noted that this allowance was accomplished by amortization of the costs over the life of the new issue and by adjusting the capitalization ratios and debt cost rates to allow for a return on the unamortized balance of the premiums at the average coupon rate of the new debt issued. (PECO St. No. 2, p. 17).

The OCA submitted that the portion of the regulatory asset on PECO's balance sheet consisting of $197.7 million in tender and call premiums was a reasonable candidate for securitization and would result in ratepayer savings in the near term as well

over the life of the asset. (OCA M.B., p. 15; OCA Exh. No. RLC-2 Rev., p. 2). PAIEUG did not recommend securitization of this asset. (PAIEUG St. No. 3, p. 8).

f. SFAS 106

SFAS 106 became effective January 1, 1993, and established a requirement that employers utilize an accrual method of accounting to recognize expenses associated with the provision of benefits other than pensions to retired employees. (PECO St. No. 2, pp. 23-24). PECO's allocation of SFAS 106 to generation function was based upon the proportion of generation-related labor expense to total labor expense. (PECO St. No. 2, p. 26). PECO requested that $45.8 million be included in its securitization claim at this time. (PECO Exh. No. TPH-6).

PAIEUG proposed material adjustments to PECO's claim, including reflecting the present value of the SFAS 106 assets in stranded costs, with which PECO agreed. (PAIEUG St. No. 3.0, pp. 16-23; PECO M.B., pp. 33-34). PAIEUG quantified the 1993 and 1994 SFAS 106 deferral components at $19.885 million and reduced the SFAS 106 deferred costs by the expected earnings on an external trust fund quantified at $83.913 million. (PAIEUG St. No. 3.0, pp. 20-23).

The OCA recommended that the deferred SFAS 106 costs should not be securitized at this time, noting there would be a net lifetime cost associated with securitizing the SFAS 106 asset. The OCA asserted that the costs associated with the early retirement program had not been incurred, and the Commission had not made a finding of their reasonableness. (OCA M.B., pp. 21-22)

Appendix C

In his discussion, the ALJ noted that Section 2803 of the Act following definition:

> "Transition or Stranded Costs." An electric utility's known and measurable net electric generation-related costs, determined on a net present value basis over the life of the asset or liability as part of its restructuring plan, which traditionally would be recoverable under a regulated environment but which may not be recoverable in a competitive electric generation market and which the commission determines will remain following mitigation by the electric utility.

The ALJ pointed out that Section 2812(a)(2)(iii) charges that the Commission should only issue a QRO for the amount of stranded costs that it determines to be just and reasonable for the utility to recover from ratepayers. In determining what amount of stranded regulatory costs PECO should be allowed to securitize at this time, the ALJ noted that he had already concluded that the legislative intent is for the Commission to allow securitization of stranded costs that are, at worst, minimally controversial and to include only items that are properly identified and quantified.

In the development of his conclusion, the ALJ submitted that the QRO will be irrevocable, thus this recommendation will impact present and future customers for the next ten years. Based on the information presented in this proceeding and the law governing the restructuring of the electric utility industry, the ALJ concluded that he could not endorse securitization of any stranded regulatory assets that could have a negative impact on ratepayers (i.e. increasing their costs rather than lowering their rates). (R.D., pp. 36-37).

Appendix C

The ALJ discussed the fact that witnesses on behalf of the OCA and PAIEUG took issue with certain aspects of the regulatory asset claim, but did recognize that certain regulatory assets were appropriate for securitization at this time. (OCA St. No. 1. p. 4; PAIEUG St. No. 3.0, p. 8). PAIEUG recommended that PECO be permitted to recover regulatory assets in the amount of $629 million in this proceeding, and the OCA recommended the recovery of $514 million. (PAIEUG M.B., p. 33; OCA M.B., p. 18). At the other extreme, the OTS recommended zero securitization of regulatory assets. (OTS M.B., p. 14).

The ALJ concluded that PECO did not meet its burden of proof in demonstrating the justness and reasonableness of the total amount of stranded regulatory assets that it sought to securitize at this time. The OCA acknowledged that four of the eight regulatory assets PECO has requested to securitize include amounts that are known and measurable and are amounts that the Commission has in the past allowed as regulation assets. The OCA's recommendation of $514 million includes $220.1 million that is already reflected in rates for carrying charges and deferred depreciation on 50% of Limerick and Eddystone/ Peach Bottom/Salem common plant, $96 million that is the actual undercollected energy costs, and $197.7 million that is based on refinancing premiums (an item which the Commission has allowed PECO a return of and a return on in the past). (OCA M.B., pp. 15-18). PAIEUG also agreed that actual undercollected energy costs could be securitized at this time. (PAIEUG M.B., p. 46).

The ALJ reasoned that to be in compliance with Section 2803 of the Act's definition of stranded cost, those amounts must be further discounted at the OTS recommended rate of

7.53% over the ten year ITC period. (R.D., pp. 37-39). (This present value adjustment is discussed in Item 3 of Section D).

The Environmentalists except to the ALJ's Alternative Recommendation which adopts the OCA's noncontroversial regulatory assets as QRO candidates, discounted to $321.540 million. The Environmentalists maintain that the OCA's designated assets are non-plant related items and the Act prohibits their securitization because PECO never applied for the securitization of these assets. (Environmentalists Exc., pp. 17, 19).

The Environmentalists argue that:

> This reading is consistent with the scope of review which the Act requires. There is a way to reconcile the limiting language of the "expedited" subsection with the clear, and broad, definition of the "transition or stranded" costs it mentions — matters presentable in analyzing the utility case are broader than what the Commission can incorporated into its relief. The language of the section can be read to **limit the relief, not the record** on which the Commission must make its findings:
>
> > . . . .The commission shall **consider only the portion of the transition or stranded costs for which the utility requests approval** to issue transition bonds. Consideration of all remaining amounts and amounts not resolved by the commission shall be deferred for consideration in the electric utility's

restructuring plan proceeding under section.[11]

* * *

Another reason for construing "shall consider only the portion" as a limitation on relief rather than on the evidence is the other, explicit direction that the subsection gives to the Commission, limiting it to approving:

> . . . . for a portion of the utility's transition or stranded costs that the commission **finds** would be **just and reasonable** to recover from ratepayers **under sections 2804 and 2808**.

The language requires findings of fact, under the case law addressing "just and reasonable", and, specifically, the requirements of two sections, 2804 and 2808. While §2804 is relatively simple to address — the capped rates — §2808 presents additional issues of fact, including the determination of regulatory assets and the steps taken to "mitigate" stranded investment.

(Environmentalists Exc., pp. 19-20; emphasis added in Exception).

In Exceptions, PECO submits that its proposal to securitize $1.2 billion in claimed stranded regulatory assets should not

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11. Act §2812(b)(1)(i).

be denied because the specific costs which PECO is seeking to securitize not only would be recoverable in a regulated environment, but, in fact, either are currently being amortized through existing rates or have been recognized by the Commission for future recovery. (PECO Exc., p. 15).

PECO asserts that the Environmentalists misinterpreted the plain language of the Act, in contending that §2812(b)(1)(i) limits the Commission to either granting or denying a utility's securitization request in its entirety. PECO submits that the language of that section says no such thing. Rather, PECO maintains that the Commission cannot grant a QRO for an amount that exceeds the Company's request. In addition, PECO maintains that nothing in that section of the Act proscribes the Commission's exercise of discretion to alter the mix of stranded costs to be securitized, so long as those costs in total do not exceed the amount the Company requested. PECO submits that the requirement that a utility must provide "a complete account of [its] . . . transition or stranded costs" (§2812(a)(2)(i)), assures that the Commission has a complete evidentiary record to support the level and mix of stranded costs it may ultimately approve for securitization. (PECO R. Exc., pp. 18-19).

In Reply Exceptions the OCA notes that it opposed and continues to oppose PECO's request to securitize any other regulatory assets — in whole or in part — in this proceeding. Specifically, the OCA submits that PECO's request to securitize Limerick 1 and Limerick 2 Early Window costs; deferred SFAS 106 costs; "deferred" future fuel costs; and deferred SFAS 109 tax expense should be denied, and consideration of these claims deferred until the Company's restructuring proceeding. (OCA R.E., p. 12).

Appendix C

We accept PECO's request to securitize deferred fuel costs of $96.162 million which represents its actual undercollected energy costs from February 1, 1996 to December 31, 1996, including its earned nuclear performance bonus for calendar year 1996 and interest. This amount is known, measurable and certain. PECO's request to securitize future fuel costs of $143.3 million represents costs which have not yet been incurred. As such, this portion of PECO's claim is speculative. We, therefore, will include the 1996 undercollection of $96.162 million in the approved securitization and defer the projected undercollection to the restructuring proceeding.

We accept $179.7 million of PECO's claim to securitize unamortized loss on reacquired debt. This amount represents the December 31, 1998, estimated balance for tender and call premiums incurred by PECO. The Commission has allowed PECO both a return-of and a return-on such premiums to encourage economic refinancing of high coupon debt, and securitization of this regulatory asset will produce ratepayer savings.

We approve securitization of $175.812 million of deferred carrying charges and depreciation expense associated with 50% of Limerick common plant, representing the estimated balance as of December 31, 1998. This cost is already reflected in rates and securitization will result in ratepayer savings both initially and over the remaining amortization period.

We also approve securitization of deferred carrying charges and depreciation expense associated with 50% of common plant of the Eddystone, Peach Bottom, and Salem generating stations. These costs, $17.4 million as of December 31, 1998, are already reflected in rates and securitization will result in savings to ratepayers.

Therefore, we agree in theory with the OCA's recommendation regarding the following regulatory assets in the securitization at their full book value: (a) Unamortized Loss on Reacquired Debt; (b) Carrying Charges and Deferred Depreciation on 50% of Limerick Common; and (c) Carrying Charges and Deferred Depreciation on 50% of Eddystone/Peach Bottom/Salem Common Plant.

The OCA computed the value of these regulatory assets as $417.971 million as of December 31, 1997. However, in order to be consistent with the time frame for the plant analysis, the secured amount to be approved is the estimated balance as of December 31, 1998, which is $469.079 million for both the regulatory assets and the deferred fuel.

PECO's request to securitize deferred Early Widow costs for Limerick 1 and 2 costs and SFAS 106 costs is deferred without prejudice to its restructuring proceeding at Docket R-00973953, where the controversies and factual issues presented by PECO's request can be resolved.

Accordingly, the Exception of the Environmentalists, that the Act prohibits the Commission from considering certain regulatory assets for securitization, because PECO has not asked for them, will be denied. Nothing in Section 2812(b)(1)(i) of the Act prohibits our discretion to alter the combination of stranded costs to be securitized, as long as those costs do not exceed the Company's total QRO request.

2. SFAS 109 — Tax Deferrals and Credits

Statement of Financial Accounting Standards 109, "Accounting for Income Taxes." (SFAS 109) required PECO

to record a regulatory asset to reflect its right to recover deferred tax liabilities generated by the effects of tax/book timing differences that had been "flowed-through" to customers in the ratemaking process. (PECO M.B., p. 26). Other issues related to SFAS 109 are accumulated deferred income taxes and unamortized investment tax credits. (PECO M.B., p. 26). PECO sought securitization of $675.6 million of its regulatory SFAS 109 assets, (PECO Exh. No. TPH-6).

The ALJ reviewed the positions of the parties noting that the OCA recommended that PECO's claim for securitization of its deferred tax regulatory asset not be included in this proceeding. In addition, PAIEUG recommended that PECO be allowed to securitize $550.5 million of SFAS 109 assets and recommended that PECO's stranded costs claim be reduced by the total accumulated deferred income tax liability of $1.0 billion. (R.D., p. 34).

The ALJ reviewed the details of PAIEUG's recommendation which included the following adjustments: the gross SFAS 109 regulatory asset should be offset with the SFAS 109 liability; recoveries from ratepayers for future taxes should be discounted to the present value before being included as stranded costs for ITC purposes; and the accumulated deferred investment tax credit liability should be treated the same as the gross SFAS 109. (R.D., pp. 34-35).

In his analysis the ALJ concluded that the claim for stranded regulatory assets in the amount of $675.6 million for deferred tax liabilities recorded pursuant to SFAS 109 remains controversial. The ALJ further concluded that PECO failed to bear its burden of proof and, thus, has not given reasonable assurance that these are items that should be securitized as

regulatory stranded costs at this time. Thus, the ALJ recommended that the PECO's proposal to securitize deferred tax regulatory assets not be included in this proceeding. (R.D., pp. 34-39).

In its Exceptions, PECO submits that the largest single component of PECO's stranded regulation assets consists of the deferred tax liabilities recorded pursuant to SFAS 109 which totals $1.86 billion. For purposes of this proceeding PECO requested recovery of $675.6 million of this identified amount. PECO maintains that while the ALJ addressed the concerns expressed by the OCA and PAIEUG regarding the Company's claim, he neglected to mention that PECO demonstrated, beyond any reasonable doubt, that the criticisms leveled by the opposing parties reflected a very fundamental misunderstanding of the operation of SFAS 109. PECO argues that its right to recover these costs is entirely consistent with existing ratemaking practice. PECO maintains that the claimed SFAS 109 costs have been fully debated, are based on record evidence, and should be accepted. (PECO Exc., pp. 15-21).

In its Reply Exceptions the OCA submits that PECO's massive claim for SFAS 109 deferred tax liability is wholly inappropriate for securitization at this time. The OCA maintains that it is necessary to deny those elements of the Company's securitization proposal where it includes regulatory assets whose ultimate recovery are subject to significant dispute, are uncertain in amount, or have not previously been reviewed by the Commission for inclusion in rates. The OCA supports the ALJ's determination that PECO's securitization claim for SFAS 109 deferred taxes is highly uncertain and should be deferred to the Company's restructuring proceeding. (OCA R.E., pp. 14-15).

Appendix C

The OCA's principal concern with PECO's claim is that it appears that the Company has failed to reflect the present value of its overall deferred tax liability owed in the future. The OCA notes that PECO's $1.7 billion portion of its SFAS 109 regulatory asset, associated with generation plant, is the undiscounted amount of the obligation by ratepayers to indemnify PECO for future tax costs associated with deferrals where benefits were flowed through to ratepayers. The OCA maintains that this amount is not discounted and, further, is grossed-up to include the additional taxes which will be payable on the additional revenues needed to cover the deferred income taxes, or the tax-on-tax effect. For purposes of determining stranded costs on tax related regulatory assets, the OCA submits that the approach should be one of settling final accounts where ratepayers should only be required to cover the true cost of the tax indebtedness on a present value basis. (OCA R.E., pp. 15-16).

The OCA concludes that given the irrevocable nature of a securitization order, the Commission should not securitize any portion of PECO's deferred tax regulatory asset claim at this time, and it further notes that PECO has the right to renew its claim in its current restructuring proceeding. (OCA R.E., p. 19).

PAIEUG argues in its Reply Exceptions that PECO's SFAS 109 regulatory asset was computed incorrectly because (1) the Company failed to offset its gross SFAS 109 asset with the accumulated deferred tax liability recognized on PECO's balance sheet and (2) the Company failed to discount recoveries from ratepayers for future taxes to the present value as required by the definition of transition and stranded costs in the Act. (PAIEUG St. 3.0. p. 26). PAIEUG submits that the Company treated its deferred tax liabilities and SFAS 109 asset

inconsistently, and PECO failed to discount its future net SFAS 109 regulatory asset, even though PECO discounted the asset for other purposes. (PAIEUG R.E., pp. 9-10).

PAIEUG asserts that the disallowance of PECO's claim to securitize SFAS 109 costs is appropriate due to its complexity; PECO's Exception must be denied. (PAIEUG R.E., p. 11).

Premised on our review of the record as developed in this proceeding and the arguments proffered, we conclude that given the irrevocable nature of a securitization order, the Commission should not securitize any portion of PECO's deferred tax regulatory asset claim at this time. The presentation of conflicting evidence by PECO, the OCA, and the PAIEUG on this issue raises question that can only be answered with further hearings. PECO's request to securitize its SFAS 109 regulatory asset claim is, therefore, deferred without prejudice to its restructuring proceeding at Docket R-973953.

Accordingly, the Exception of PECO on this issue will be denied and the recommendation of the ALJ is adopted.

3. Present Value Adjustment

In the Recommended Decision, the ALJ stated that, if we do not approve his primary recommendation to deny PECO's Application, we should, in the alternative, allow PECO to securitize only the regulatory asset amounts recommended by the OCA as being just and reasonable. This would result in an allowance of $514 million for this claim. The ALJ further determined that, in order to comply with the definition of stranded costs contained in Section 2803 of the Act, this amount should be discounted at the discount rate of 7.53 percent recommended by the OTS over the ten-year ITC period.

Accordingly, the ALJ recommended that we permit PECO to securitize $321.540 million of its regulatory assets claim. (R.D., pp. 38-39).

In its Exceptions, PECO argues that the ALJ erroneously and without any support in the record concluded that Section 2803 of the Act somehow requires the discounting of the $514 million of stranded regulatory assets found reasonable by the OCA. PECO contends that the ALJ's recommended discounting should be rejected for two reasons. The first is that no party, including the OCA, ever suggested that this amount needed to be discounted. Consequently, PECO submits, the record is devoid of support for the discounting recommended by the ALJ. The second reason is that, according to PECO, discounting would be appropriate only if PECO was *not* entitled, under traditional ratemaking principles, to earn a return on the assets in question. PECO points out that the OCA specifically selected those items on which PECO did earn a return so as to maximize the corresponding base rate reduction. (PECO Exc., p. 21).

In its Reply Exceptions, the OCA submits that the ALJ's recommendation to discount the $514 million in stranded regulatory assets should be rejected. The OCA concurs with PECO that the $514 million is the proper amount to be granted as stranded regulatory assets, and that discounting regarding this issue is not appropriate. (OCA R.E., p. 19).

In considering this issue, we concur with PECO and the OCA that it is not appropriate to discount the stranded regulatory assets, as recommended by the ALJ. As noted by PECO, the discount applied by the ALJ was improper and not conceptually sound. An updated cost of capital may be applicable to the removal of the asset from rates, and a comparable discount is part of the economic analysis to support

decision making. However, neither is applicable to the balance on the books for these particular regulatory assets. Accordingly, we shall grant PECO's Exception on this issue and reject the ALJ's recommendation to perform a present value adjustment on the stranded regulatory assets which we are approving for PECO in this proceeding.

E. Rate of Return and Discount Rate

1. Introduction

The issue of rate of return arises in this proceeding for the purpose of establishing a discount rate for the securitized assets. Determining the discount rate is necessary to properly account for the changing value of money over time. Regarding a utility's rate of return, a public utility is entitled to an opportunity to earn a fair rate of return on the value of its property which is dedicated to public service. *Pennsylvania Gas & Water Company v. Pennsylvania Public Utility Commission*, 19 Pa. Commonwealth Ct. 214, 341 A.2d 239 (1975).

2. Capital Structure

In its initial filing in this proceeding, PECO claimed the following capital structure:

Capital Structure	Ratio	Cost Rate	Weighted Cost
Debt	55.00%	10.04%	5.52%
Preferred Stock	9.20%	10.13%	0.93%
Common Equity	35.80%	12.75%	4.56%
	100.00%		11.02%

(PECO Exh. No. ABC-7, p. 4, R.D., p. 39). Based upon this capital structure and cost rates, PECO claimed an after-tax discount rate of 8.88 percent. (PECO Statement No. 1-R, p. 5).

Appendix C

The position of the OTS concerning PECO's capital structure was as follows:

Capital Structure	Ratio	Cost Rate	Weighted Cost
Debt	44.60%	8.47%	3.78%
MIPS Debt*	3.19%	9.21%	0.29%
Preferred Stock	3.09%	7.70%	0.24%
Common Equity	49.12%	10.00%	4.91%
	100.00%		9.22%

*MIPS is an acronym for "Monthly Income Preferred Shares." (PECO Exhibit No. JFB-1, Sch. 9 Revised).

This resulted in an after-tax discount rate of 7.53 percent. (R.D., p. 41).

In the rebuttal stage of the proceeding PECO adopted the following position on Capital Structure ratios: Debt, 44.6 percent; MIPS Debt, 3.2 percent; Preferred Stock, 3.1 percent; Common Equity, 49.1 percent, which is essentially the same as the OTS' position. PECO also revised its claim for the cost of common equity to be 12.10 percent, which resulted in an after-tax discount rate of 8.60 percent.

Accordingly, the OTS' witness Deardorff and PECO's witness Brennan agreed on capital structure, but not on the cost of common equity and the discount rate, which will be discussed later. The ALJ recommended use of the capital structure to which the OTS and PECO agreed as the appropriate one for this proceeding, as it represents PECO's actual capital structure on December 31, 1996. (R.D., pp. 41, 45).

We have examined the capital structure to which PECO and the OTS have agreed. We determine it to be the appropriate

capital structure for use in this proceeding, in light of the fact that it represents PECO's actual capital structure on December 31, 1996. Accordingly, we approve use of the following Capital Structure ratios in this proceeding: Debt, 44.60 percent; MIPS Debt, 3.19 percent; Preferred Stock, 3.09 percent; Common Equity, 49.12 percent.

3. Cost of Debt and Preferred Stock

Both the OTS' witness Deardorff and PECO's witness Brennan agreed on PECO's non-MIPS debt cost rate as being 8.47 percent. However, these parties disagreed on the cost of MIPS debt and preferred stock. PECO claimed that the MIPS debt cost rate was 8.93 percent and the preferred stock cost rate was 9.21 percent. The OTS stated that the MIPS debt cost rate was 9.21 percent and the preferred stock cost rate was 7.70 percent. In its Main Brief, at page 20, the OTS contended that PECO did not challenge its corrections to these costs rates. (R.D., p. 42).

The ALJ recommended adoption of the non-MIPS debt cost rate of 8.47 percent agreed upon by the parties as being reasonable. He further recommended the adoption of the MIPS and preferred stock rates of 9.21 percent and 7.70 percent as being reasonable in this proceeding.

We determine that the use of the non-MIPS debt cost rate of 8.47 percent agreed upon by the parties is reasonable. Furthermore, we conclude that PECO's claim contained incorrect costs for MIPS debt and preferred stock. Accordingly, we will adopt the cost rates of 9.21 percent for MIPS and 7.70 percent for preferred stock.

Appendix C

4. Cost of Common Equity

PECO's final claim for its cost of common equity rate was 12.10 percent, based on its Discounted Cash Flow (DCF) and Capital Asset Pricing Model (CAPM) analyses which resulted in costs of common equity of 12.20 percent and 11.90 percent, respectively. The OTS argued that PECO's cost of common equity was 10.00 percent, based on the OTS' DCF analysis. The ALJ recommended adoption of the OTS cost of common equity of 10.00 percent recommended by the OTS. The ALJ based his recommendation on the Commission's current use of the DCF model, and rejection of the CAPM model, for determining the cost of common equity, and his determination that the OTS barometer group was reasonable. According to the ALJ, this results in a discount rate of 7.53 percent, (R.D., pp. 42, 46-47).

In its Exceptions, PECO argues that the ALJ's recommendations of a cost of common equity of 10.00 percent and a resulting discount rate of 7.53 percent appear to be based on the ALJ's erroneous conclusion that PECO would be less risky following securitization, and that the shift of the risk from the shareholders to the customers warrants the use of the OTS' lower capital costs. PECO contends that, if the lower cost of capital proposed by the ALJ were used, it would reduce PECO's estimated stranded costs. At the same time, PECO alleges that it would lessen the base rate reductions proposed by PECO in this proceeding. (PECO Exc., pp. 21-22).

PECO contends that the ALJ's proposed cost of common equity rate of 10.00 percent and discount rate of 7.51 percent should be rejected because the ALJ has misconstrued the effect of the securitization on shareholders and customers. PECO

submits that its proposal already fully compensated customers for any risk reduction achieved through securitization. PECO points out that the OCA's witness La Capra acknowledged that one indication of the magnitude of the reduction in risk to customers is the difference between what the market pays for securitized and unsecuritized capital.

PECO further contends that the OTS' cost of common equity rate of 10.00 percent is deficient because it relies solely on the DCF method and utilizes a barometer group which is clearly less risky than PECO's. Moreover, PECO argues that the OTS' analysis is deficient because it employs dividend yield dating back to early 1996, "when no one had reason to believe that electric restructuring legislation would be enacted as quickly as it was." (PECO Exc., p. 23).

In response, the OTS supports the ALJ's recommendation and argues that PECO's Exception on this issue is without merit. The OTS points out that PECO originally claimed a discount rate of 8.88, even though its cost of capital witness in this proceeding, Mr. Brennan, testified that the appropriate discount rate for PECO is 8.66 percent. The OTS submits that the discount rate of 7.53 percent calculated by its witness, Deardorff, employing the DCF method, is based on PECO's net present value calculation to determine the current market value of PECO's generation plant. The OTS contends that the calculation of a current market value requires the use of PECO's current cost of capital as the discount rate in this calculation. (OTS R.E., pp. 3-4).

The OTS argues that the ALJ properly determined that PECO will be less risky after securitization. To support this argument, the OTS points to the testimony of PECO's own

witness. Hill, who testified that approval of PECO's securitization Application would eliminate some of the uncertainty around the Commonwealth's restructuring efforts, citing PECO Statement No. 1, p. 25. (OTS R.E., p. 5).

The OTS also responded to PECO's argument that the OTS' cost of equity at 10.00 percent is too low in view of the fact that PECO's dividend yield is close to 9.00 percent. The OTS argues that the testimony of the OTS' witness Deardorff established that PECO's dividend is currently high because of the pendency of this securitization proceeding. The OTS contends that this increased risk is only short term and should not be considered in any analysis of long term capital cost rates. The OTS submits that, for this very reason, the analysis presented by its witness Deardorff relies heavily on a 52-week dividend average and not the three-month and six-month spot yields upon which PECO relies.

Regarding PECO's argument that the OTS' cost of equity determination is deficient because it relies solely upon the DCF method, the OTS contends that the ALJ appropriately found that, in numerous cases since 1989, the Commission has utilized the DCF method and informed judgment, citing *Pennsylvania Public Utility Commission v. Philadelphia Suburban Water Company*, 71 Pa. PUC 593, 623-632 (1989) and *Pennsylvania Public Utility Commission v. Western Pennsylvania Water Company*, 67 Pa. PUC 529, 559-570 (1988).

With respect to PECO's argument that the OTS used stale dividend information, the OTS points out that it employed a 52-week dividend average in order to counter the short term volatility attributable to the uncertainty of PECO's securitization filing. PECO's own calculation using a three and

six month spot yield improperly inflates the dividend results. Accordingly, the OTS submits that PECO's Exception regarding this matter should be denied. (OTS R.E., pp. 6-7).

In their Reply Exceptions, the Environmentalists also contend that PECO's Exception concerning the cost rate of common equity and the discount rate should be rejected. The Environmentalists argue that, until this Commission is able to examine thoroughly the present value methodology and discount rate issues, the ALJ's alternative recommendation should be adopted.

The Environmentalists assert that PECO presented no good reason for this Commission to rely on PECO's cost of common equity from its 1989 rate case, as PECO advocated in its original Application. The Environmentalists further argue that PECO's recitation of shareholder "costs" omits a fairly obvious consideration, that "securitization removes from PECO *pro tanto* the substantial likelihood of failure in a price-competitive electric industry." (Environmentalists' R.E., pp. 12-13).

In considering this matter, we note that, in numerous recent proceedings, we have determined a utility's cost of common equity using primarily the DCF (Discounted Cash Flow) method and informed judgment. *Pennsylvania Public Utility Commission v. Roaring Creek Water Company*, Docket No. R-00943177 (Order entered on May 31, 1995); *Pennsylvania Public Utility Commission v. Philadelphia Suburban Water Company*, *supra*. Regardless of the procedure employed in determining the fair rate of return for a utility, we exercise informed judgment. *Pennsylvania Public Utility Commission v. West Penn Power Company*, *supra*. Therefore, we reject PECO's argument that the OTS' reliance solely on the DCF methodology is improper in this proceeding.

Furthermore, we determine that the OTS proposed return on common equity rate of 10.00 percent and resulting discount rate of 7.53 percent is proper in this proceeding. We find the OTS' use of the 52-week dividend average methodology to be superior to PECO's use of the three-month and six-month spot yields because the 52-week dividend average is not as easily skewed by the short term risk increase, and provides a better indication of the long term capital cost rates. The evidence of record in this proceeding demonstrates that PECO's use of a dividend yield based on three and six-month time periods overstates PECO's investment risk. PECO's dividend is currently uncharacteristically high because of the pendency of the securitization proceeding. (*See* OTS St. No. SR-2, pp. 2-3).

We also find that the barometer group used by the OTS is more appropriate, under the circumstances in this proceeding. PECO contends that the OTS barometer group is comprised of companies which are less risky than PECO. While PECO contends that the securitization process has produced uncertainty for PECO's shareholders, nevertheless. PECO's witness Hill testified that approval of PECO's securitization Application would eliminate some of the uncertainty surrounding the Commonwealth's restructuring efforts. (PECO Statement No. 1, p. 25). The evidence of record in this proceeding establishes that PECO's witness Brennan compared bond ratings in his analysis of the barometer group risk. In contrast, the OTS' witness Deardorff examined equity issues in comparing the risks of the companies in his barometer group. (OTS Exh. 2. Sch. 3). We determine that the barometer group used by the OTS is more representative of the risk which PECO faces at this time and will adopt it in this proceeding. Accordingly, we deny PECO's Exception concerning its cost of common equity recommended in this proceeding and adopt a common equity cost rate of 10.00 percent.

5. Conclusion

The following table summarizes our determinations regarding the appropriate capital structure and cost of capital rates to be used in this proceeding.

Capital Structure	Ratio	Cost Rate	Weighted Cost
Debt	44.60%	8.47%	3.78%
MIPS Debt	3.19%	9.21%	0.29%
Preferred Stock	3.09%	7.70%	0.24%
Common Equity	49.12%	10.00%	4.91%
	100.00%		9.22%

This results in an after-tax discount rate of 7.53 percent.

F. Equity Buy Back and Transaction Costs

1. Use of Proceeds — Special Dividend

In its Application, PECO indicated that it would use a portion of the securitization proceeds to reduce its common equity capitalization. (PECO Statement No. 4, p. 14). The OTS and the OCA proposed reducing common equity through a special dividend. PAIEUG argued that the refunding expense from the common equity buy back would be inappropriate for recovery through the ITC. PECO rejoined that declaring a special dividend would render a portion of the Act meaningless (R.D., pp. 51-54).

The ALJ noted that a degree of flexibility is necessary for PECO and observed that PECO had promised to refund the difference to ratepayers, citing PECO Statement No. 3, p. 12 and No. 4-R, p. 4. The ALJ concluded that the goal of

securitization is to pass the cost of capital savings on to the customers. Therefore, the ALJ determined that this result would be best achieved through the special dividend approach proposed by the OCA and the OTS. (R.D., pp. 54-55).

In its Exceptions, PECO argues that the ALJ's recommendation to use an "imputed special dividend" approach for the purpose of calculating transaction costs, and thus avoiding the payment of "acquisition premiums," is contrary to the intent of the Act. PECO asserts that the Act specifically provides that a utility may recover acquisition premiums as part of its QTE. To support its position, PECO cites Sections 2812(g) and 2812(b)(5) of the Act. 66 Pa. C.S. §§2812(g) and 2812(b)(5), as well as the OCA Statement 1, page 54 and PAIEUG Statement 3, page 47. (PECO Exc., pp. 23-24).

In response, both the OCA and the OTS support the ALJ's recommendation. The OCA argues that the ALJ correctly rejected the inclusion of acquisition premiums as unnecessary and avoidable, and which would significantly reduce the benefits of securitization. The OCA points out that these acquisition premiums total $100 million and represent a substantial cost to ratepayers.

With respect to PECO's argument that the Act specifically allows recovery of acquisition premiums, the OCA contends that the Act does not authorize the recovery of acquisition premiums if they are not reasonably necessary expenses. The OCA submits that it is not reasonable to allow the recovery of excessive transactional costs which are both unnecessary and avoidable. The OCA asserts that use of a special dividend is a reasonable way to avoid these acquisition premiums. (OCA R.E., pp. 19-21).

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The OCA submits that, if PECO's proposed equity premiums are included as QTE within the QRO, PECO will have no incentive to reduce or eliminate these costs for the benefit of ratepayers. Accordingly, the OCA concludes that PECO's Exception on this issue should be denied. (OCA R.E., pp. 23-24).

In its Reply Exceptions, the OTS also supports the ALJ's recommendation to reject PECO's $100 million claim for acquisition premiums. The OTS argues that, while these costs are recoverable under the Act, as argued by PECO, the real issue is whether these costs should be incurred at all. The OTS contends that Section 2808(c)(4) of the Act requires PECO to mitigate its stranded costs, "that requirement certainly extends to a responsibility to avoid unnecessary stranded costs." The OTS contends that in this proceeding PECO has the ability and the obligation to avoid these costs by using the special dividend method. Therefore, the OTS submits that PECO's Exception on this issue must be denied. (OTS R.E., pp. 9-11).

In reviewing this issue, we conclude that consideration of PECO's Application for recovery of common equity premiums which exceed the market price should be deferred at this time. This will provide the parties with an opportunity to address this issue in greater depth in the restructuring proceeding. Accordingly, we will defer our decision on this issue to PECO's restructuring proceeding, or until such time as PECO declares and pays such premiums.

We further note that, with regard to the other issuance costs claimed in this proceeding associated with debt and preferred stock, the remaining servicing costs of $41.8 million for debt and $7.6 million for preferred stock, as well as the proposed

issuance expense of $23.8 million, must be prorated to reflect the level of costs approved herein for securitization. This proration is necessary because the amounts claimed by PECO were based on its original claim for stranded costs of $3.773 billion, and here, we are only permitting recovery of $1.098 billion.

2. Commission Right to Change Use of Securitization

In his discussion of equity buy back and transaction costs, the ALJ recommended that this Commission reserve the right to change the use of the securitization proceeds if PECO has not completed the issuance of bonds prior to completion of its restructuring case. (R.D., p. 47). The ALJ determined that the goal of securitization is to pass the cost of capital savings on to customers and concluded that this end will be best achieved through the special dividend approach proposed by the OCA and the OTS. (R.D., p. 55).

PECO excepts to this recommendation, arguing that the ALJ's recommendation is based upon a misunderstanding of the Commission's potential role regarding the use of securitization proceeds to reduce PECO's capitalization. PECO contends that the record in this proceeding contains substantial testimony that the optimal method for capitalization reduction will depend on the market conditions at the time the proceeds become available for use and can only be determined at that time. According to PECO, neither PECO nor this Commission has control over those market conditions. PECO submits that there is no evidence of record in this proceeding to establish that the requirement that PECO retain flexibility in implementing the details of its capitalization reduction. Therefore, additional Commission intervention into this issue is not warranted. (PECO Exc., pp. 25-26).

In examining this issue, we concur with PECO that a certain degree of flexibility will be necessary in its capitalization reduction proposed in this Application. However, we believe that it is necessary at this time to expressly reserve our right to change the use of the securitization proceeds in the event PECO has not completed the issuance of bonds prior to the completion of its restructuring proceeding. This is necessary because our determination in PECO's restructuring proceeding at Docket No. R-00973953 may alter PECO's capital structure. Accordingly, PECO's Exception regarding this issue is denied.

G. Rate Design

PECO proposed to allocate its base rate revenue reduction and ITC among the various customer classes using the same methodologies which it employed in its last base rate proceeding. PECO used the four coincident peak (4CP) method to allocate the proposed base rate revenue reduction since nearly all of its claimed stranded costs are capacity related generation costs and the 4CP method was used in its last rate case to allocate such costs. (PECO St. 2, p. 42).

The OSBA generally agreed with PECO's use of the 4CP allocation method. However, the OSBA proposed that the allocation factor be modified to accommodate the different rates of return provided by the various customer classes. The OSBA asserted that it was important to incorporate actual class rates of return because most of the proposed revenue reduction is related to the system average return component of PECO's generation-related revenue requirement. (OSBA M.B., p. 26). Accordingly, the OSBA offered certain refinements to PECO's allocation methodology. (*Id.*, p. 28).

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Both the OCA and PAIEUG objected to the OSBA's proposed changes to PECO's method.

The OCA argued that the OSBA's proposal has implications for other issues, such as future rate unbundling, which could not be fully examined in this proceeding. In view of this, the OCA asserted that any consideration of an appropriate allocation method should be postponed until PECO'S restructuring proceeding. (OCA St. 1R, pp. 1-2).

PAIEUG contended that the OSBA's proposal is seriously flawed and may result in inter-class cost shifting which would violate the requirements of the Act. (PAIEUG M.B., pp. 4-5)

The ALJ rejected the OCA's and PAIEUG's positions and recommended that the OSBA's modifications to PECO's proposed allocation method be approved. According to the ALJ,

> Neither the OCA nor PAIEUG provided adequate proof that the OSBA's modification to the 4CP allocation factor in this case will have any meaningful effect on cost allocation and rate design in the restructuring proceeding.

(R.D., p. 64)

In its Exceptions to the ALJ's recommendation, the OCA insists that any proposed modifications to PECO's allocation methodology should await full examination in PECO's restructuring proceeding. Noting that the Act provides for unbundled rates and a rate cap, the OCA asserts that:

> Without reviewing fully unbundled rates, it is unclear whether the OSBA proposal will produce

results that have the potential to violate the rate cap. 66 Pa. C.S. §2804(4)

(OCA Exc., p. 7)

The OCA also contends that it is not clear whether adoption of the OSBA's allocation proposal will result in the shifting of costs between customer classes, and it provides an example of how this may occur. (*Id.*, p. 8).

We agree with the OCA's position on this issue. PECO's current rates were designed in its last base rate case to recover revenue requirements assigned to each customer class. Those revenue requirement assignments reflect different class rates of return which we approved in that case. We are concerned that an adjustment in this case, without the benefit of a full examination of unbundled rates or revenue requirement allocations, may improperly shift costs and could violate the rate cap.

Accordingly, the OSBA's proposed modification to PECO's allocation methodology will be rejected in this proceeding but will be deferred for full consideration in the restructuring proceeding. The OCA's Exception to the ALJ's recommendation on this issue will, therefore, be granted.

H. Float or Interest on Transition Bond Proceeds and ITC Revenue

Enron contended that timing delays for various transactions in the securitization process may become a source of funds which PECO could use for a competitive advantage. Specifically, Enron asserted that PECO could receive substantial income from the float created by a delay in the use

of transition bond proceeds. Enron also observed that PECO might realize a cash working capital benefit from the timing difference created by the receipt of ITC revenues from customers and the use of those funds in servicing the transition bond obligations. (Enron M.B., p. 12).

Enron contended that permitting PECO to use these funds for any purposes other than those intended by the Act would be inconsistent with the securitization provision of the Act which is designed to create competitive neutrality. In order to address its concerns, Enron proposed that any order authorizing PECO to issue transition bonds and collect an ITC should also mandate that the following measures be taken:

> 1. Direct that the ITC revenues collected by PECO, as well as the proceeds from the transition bonds, be deposited in trust or other restricted accounts where the funds would not be available for PECO's general corporate use, but would be invested in short term securities determined to be appropriate by either the trustee or the Special Purpose Entity (SPE).
>
> 2. To the extent that delays in the use of the ITC revenues or the transition bond proceeds produce float income, that income would be used to offset security issuance and redemption expenses that PECO proposed be charged to ratepayers through the ITC.
>
> 3. Direct PECO to provide an accounting of the float income and its offset to issuance or redemption expenses in its proposed annual true-up filing.

(*Id.*, pp. 16-17)

The ALJ agreed with Enron on this issue, finding that it would be inappropriate and inconsistent with the Act to permit PECO to use funds derived from delays in the use of transition bonds or ITC revenues for any purpose that it chooses. The ALJ noted that the likelihood of significant timing delays may be small, but he determined that "some provision should be made to address the possibility of such delays." (R.D., p. 68). The ALJ accordingly recommended that the measures proposed by Enron be adopted. (*Id.*, p. 69).

PECO excepts to the ALJ's recommendation asserting that any interest earned on transition bond proceeds prior to those proceeds being used to reduce PECO's capitalization should be credited to the shareholders. (PECO Exc., p. 27). According to PECO, the purpose of securitization under the Act is not just to reduce customers bills but also to benefit shareholders by mitigating stranded costs. In this regard, PECO argues that:

> The multiple purposes of securitization are carefully balanced in the Act, . . . To credit customers with the interest earned on the proceeds would undermine that careful balance by shifting dollars from shareholders to customers in a manner not contemplated by the Act.

(*Id.*, p. 28)

As for any float or interest which might accrue on ITC revenues, PECO contends that since those revenues will be the bondholder's property the customers should not be credited with any amount. (*Id.*, p. 29).

PECO also asserts that it would not derive any competitive advantage from the float on transition bond proceeds. On this point PECO states that:

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> It is impossible to imagine that a company that has no opportunity to earn a return on its investment, but which still must pay the costs associated with earning such a return, could gain a "competitive advantage" by being allowed to earn short-term interest on its investors' own money.

(*Id.*, p. 28)

We agree with Enron's position and the ALJ's recommendation on this issue. While any competitive edge which PECO could receive from the float on transition bond proceeds or ITC revenues may not be great, such funds would represent additional cash flow and an unwarranted, if slight, advantage over competitors just as competition is commencing. Enron is correct in its assertion that any such advantage would not comport with the Act's goal of competitive neutrality. (Enron R.E., p. 4).

As for PECO's contention that any interest on transition bond proceeds should be credited to shareholders and any float on ITC revenues is the property of the bondholders, we do not agree. Notwithstanding PECO's argument that crediting customers with any float would "undermine that careful balance" between investors and customers, we find that the primary purpose of securitization is to reduce customer bills. It would be inconsistent with the Act for PECO to use any float or interest on transition bonds or ITC revenue for any other purpose.

Accordingly, we adopt the recommendation of the ALJ on this issue, and we will direct that the measures proposed by Enron for the treatment of transition bond proceeds and float

income be implemented. PECO's Exceptions on this issue will, therefore, be denied.

I. Miscellaneous Issues

1. True-up Mechanism

PECO has proposed to implement a Section 1307(a) of the Code, 66 Pa. C.S. § 1307(a), true-up mechanism to projected and actual issuance and use of proceeds expenses, and stated that Section 2812(b) of the Act directed that ITC revenue be subject to reconciliation.

PECO has also stated that Transition Bonds would be issued for an amount that included estimated issuance expenses and estimated premiums and other costs associated with the repurchase of PECO's outstanding debts and reduction of equity. PECO contended that actual issuance expenses and costs would not be known until some future point and that they could be more or less than the estimated figures. PECO argued that when an ITC was established, it could not be changed; therefore, PECO requested approval for a §1307(a) type adjustment clause for reconciliation of any differences that might occur. PECO anticipated a 12-month recovery or refund period, but stated that it might request a longer period in a situation where it was seeking to recover an undercollection.

The OCA stated that, for the purposes of this proceeding and this limited securitization, it did not object to PECO's proposed reconciliation mechanism. (OCA M.B., p. 59). However, the OCA asserted that this issue should be fully reviewed and explored in the restructuring proceeding as well as the potential for cost shifting. *Id.*

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Enron contended that any proceeds obtained by PECO through the "Float" should accrue to the ratepayers and not to the shareholders. (Enron M.B., p. 14). Enron also argued that it was PECO's position that potential additional "proceeds" from the transition bonds "Float" should accrue to PECO's shareholders, not its ratepayers and, therefore, the additional income should not be recognized as offsets to the overall cost of issuance or redemption. Enron recommended that any "Float" income should be used as an offset to issuance and redemption expenses that PECO proposes to be charged to ratepayers via the ITC.

The ALJ recommended acceptance of PECO's true-up proposal, as amended by Enron and the OCA, stating that any financial benefit accrued by PECO through the "Float" should accrue to the ratepayers and be used in the true-up of the transaction costs. Further, the ALJ recommended that this issue be fully reviewed in the restructuring proceeding as suggested by the OCA. (R.D., p. 71).

We note that no Party objected to the ALJ's recommendation on this issue. Premised on our review of the record as developed in this proceeding, we conclude that it is appropriate, and in the public interest, to direct the ALJ to fully review this issue in the restructuring proceeding.

2. Two Year Window

Although PECO expects its initial issuance of Transition Bonds to be made on or about June 30, 1997, and anticipates that all of the bonds will be issued prior to February, 1998, it has requested a two year window within which to issue all of the bonds. PECO further states that the two year window is

needed due to the sizable amount to be refinanced, the uncertain market conditions and the presumption that there will be more than one issuance. PECO also considers the two year window to be a reasonable compromise in order to provide minimum cost and maximum savings.

In light of the fact that there have been no criticisms filed or expressed against PECO's request, the ALJ adopted PECO's position as being a reasonable request. However, the ALJ noted that it is likely that there will be an appeal from the Commission's Opinion and Order and that, therefore, the future issuance of transition bonds may be delayed. In addition, the ALJ took official notice of the pending litigation in the case of *Vincent J. Fumo, et al. v. Pennsylvania Public Utility Commission, et al.*, at Docket No. 269 M.D. 1997, filed March 18, 1997, wherein the complainants allege that the adoption of the Act violates the Constitution of the Commonwealth, and concluded that it was highly likely that the pendency of this suit would prohibit the marketing of any transition bonds.

Upon consideration of the record in this proceeding, and in light of the reduction in the total amount authorized for securitization, we find that PECO should be permitted not more than a twelve (12) month window for the issuance of transition bonds to run for one year from the date of entry of this Opinion and Qualified Rate Order unless otherwise modified by subsequent action of this Commission. In balancing the interests of investors and ratepayers, we find that it is in the public interest to conclude the ITC as quickly as possible. Accordingly, PECO's request for a two-year window is denied.

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3. Incorporation of Record

The ALJ recommended that the record in this proceeding be incorporated into the record of the Application of PECO for Approval of its Restructuring Plan under Section 2806 of the Code at Docket No. R-00973953 because the parties should not be "required to relitigate their positions from scratch in the restructuring case." (R.D., p. 17).

PECO states in its Exceptions that it agrees with the ALJ in concept but not in practice. (PECO Exc., p. 29). However, PECO argues that since the parties to the restructuring proceeding would have the instant record available to them, that they should be required to designate, in advance, those specific portions of the record that they wish to utilize in the hope that this will minimize confusion and eliminate any due process concerns. (Id., p. 30).

PAIEUG argues that the ALJ properly recommended full incorporation of the record in the instant proceeding into PECO's restructuring proceeding. (PAIEUG R.E., p. 12). PAIEUG further argues that PECO's suggestion to require designation in advance would be time-consuming and inefficient and should be denied. (Id., p. 3).

The Environmentalists argue that the ALJ's recommendation to incorporate the instant record into the restructuring proceeding will conserve resources and should be approved. It is further analyzed that PECO's recommendation would have the parties undertake time-consuming surgery on the record from this proceeding whereas, the ALJ's recommendation would allow any party

disputing the incorporation to move to exclude the incorporated record on the ground of unfairness. (Environmentalist R.E., p. 15).

Based on the arguments of the parties, and the record, we question whether all of the elements of this record are of value for the restructuring case since updates on many issues have been filed. As a result, it is preferable to have the parties identify the portions of the record that they desire to include in the restructuring filing, and that liberal incorporation be extended by the ALJ in that matter. Accordingly, we will reject the recommendation of the ALJ, and grant PECO's Exceptions on this issue consistent with this Opinion and Order.

4. Exit Fees

The Environmentalists, in their Exceptions, argue that, pursuant to the Act, a utility's obligations continue after assignment of transition property, which a QRO approves, except for those customers paying exit fees "in the manner and on the basis specified in the qualified rate order." 66 Pa. C.S. §2812(b)(6)(ii). The ALJ did not address the issue of exit fees and, as a result, the Environmentalists recommend that, if the Commission does authorize a QRO and ITC, then the exit fee question should be explicitly addressed. (Environmentalists Exc., p. 21).

PECO argues that there is no necessity to impose exit fees and that nothing in the Act states that exit fees must be delineated in the QRO as a condition for issuance of a QRO. (PECO R.E., p. 19).

PAIEUG argues that the Environmentalists argument is based on a misinterpretation of the Act and there is no

requirement that a QRO must address exit fees or termination charges as a condition for a QRO. As a result, PAIEUG recommends that the Environmentalists' Exception be denied on this issue. (PAIEUG R.E., pp. 14-16).

Section 2812(b)(6) of the statute provides, in pertinent part:

> . . . *If* the Qualified Rate Order so provides, the obligations of the electric utility:
>
> (i) shall be binding upon the electric utility, its successors and assigns; and,
>
> (ii) shall be required by the Commission to be undertaken and performed by the electric utility and any other entity which provides electric service to a person that was a customer of an electric utility located within the certificated territory of the electric utility on the effective date of this chapter or that became a customer of electric services within such territory after the effective date of this chapter and is still located within such territory, as a condition to the provision of service to such customer by such electric utility or other entity, *unless the customer has paid a termination charge* in the manner and on the basis specified in the Qualified Rate Order.

66 Pa. C.S. §2812(b)(6) (emphasis added).

Based on the foregoing, it is evident that there is no mandate for a discussion of exit fees in a QRO. The statute addresses a discretionary aspect of a QRO and provides that the terms of

the QRO, which may include or authorize an ITC, are a condition of the provision of service to a customer *unless* the customer has already paid a termination charge. To the extent that a "termination charge" is referenced, it is only for the purpose of ensuring that customers who have already paid a termination charge are not required to further pay a portion of the ITC. As a result, we will deny the Exception of the Environmentalists consistent with this Opinion and Order.

5. Irrevocable QRO

The Environmentalists argue in their Exceptions that a QRO need not, and should not, be irrevocable but they do acknowledge that the Commission does have the discretion to grant or deny irrevocability, as cited earlier in this Opinion and Order. However, the Environmentalists further state that we should avoid any Constitutional pitfalls that may befall an irrevocable order and decline to declare the Order irrevocable. (Environmentalists Exc., p. 15). In addition, they also cite several "wordsmithing issues" that allegedly reflect the danger of proceeding too quickly and recommend, apparently as an alternative, that the issue of irrevocability be put off to PECO's restructuring proceeding. (Environmentalists Exc., pp. 16-17).

PECO argues that the Environmentalists' assertions regarding the issuance of an irrevocable QRO are without any basis on the record and is contrary to the applicable provisions of the Act. In addition, PECO claims that the assertions are contrary to the testimony of its witnesses, who, on the record, explained in detail why irrevocability is necessary to realize the benefits of securitization. (PECO R.E., p. 18).

The ALJ has made no specific analysis of this issue but presented the QRO as being irrevocable in his Alternate

Recommendation. (R.D., p. 37). Nonetheless, no party, including the Environmentalists, disputes the fact that it is within our discretion to issue an irrevocable Order or the contention of PECO that the irrevocability requirement is necessary to achieve the benefits of securitization.

We have reviewed the record in this proceeding concerning this issue and note that PECO, through the statement of its witness Hiller, asserted that legislation is required which creates the irrevocable right to ITC collections sufficient to fully recover QTE. PECO contended that this is necessary in order to mitigate the risk associated with a credit analysis that addresses not only the charge-off experience of PECO, as in a normal receivables securitization, but also, most importantly, the ability of PECO to generate the receivables by providing service to customers. Further, PECO asserted that it is this statutory right to future revenues which is the basis for the securitization rather than the existing receivables. (PECO Statement 5, p. 14).

Since we have the discretion to issue an irrevocable Order, doing so at this time would be in the public interest in that it would give PECO the ability to gain the most advantageous financing. Anything less than an irrevocable Order may jeopardize this ability and, ultimately, result in higher costs to its customers. As a result of the foregoing, we will exercise our discretion and issue an irrevocable Opinion and Qualified Rate Order with respect to all issues except the time frame for issuance of the transition bonds as previously referenced in Section 1(2) — Two Year Window (*supra*). Accordingly, the Exception of the Environmentalists on this issue is denied.

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V. Conclusion and Qualified Rate Order

Based upon our review of the record and the arguments presented by the Parties to this proceeding, we conclude that it is reasonable, appropriate and in the public interest to approve, in part, PECO's Application for a Qualified Rate Order. We determine that PECO should be permitted to securitize, under the terms of this Qualified Rate Order, the amount of $1.098 billion dollars, in a manner consistent with the terms of this Qualified Rate Order, **THEREFORE;**

IT IS ORDERED:

1. That the Application of PECO Energy Company for the Issuance of a Qualified Rate Order under Sections 2808 and 2812 of the Public Utility Code, 66 Pa. C.S. §§2808 and 2812, filed on January 22, 1997, at Docket No. R-00973877, be, and hereby is, granted, in part, consistent with this Qualified Rate Order.

2. That the Complaint of the Office of Consumer Advocate at Docket No. R-00973877C0001 be, and hereby is, sustained, in part, and denied, in part, consistent with this Qualified Rate Order.

3. That the Complaint of the Environmentalists, which is an *ad hoc* group consisting of: Delaware Valley Citizens' Council for Clean Air; Citizen Action; NESIP; Pennsylvania Public Interest Research Group; Philadelphia Solar Energy Association; Sierra Club; and Trout Unlimited – Pennsylvania Council, at Docket No. R-00973877C0002 is sustained, in part, and denied, in part, consistent with this Qualified Rate Order.

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4. That any issues raised by a Party to this proceeding, which are not explicitly discussed in this Qualified Rate Order, have been duly considered and are hereby denied for purposes of this proceeding.

5. That this Commission determines that it is just and reasonable and in the public interest for PECO Energy Company to recover from its customers through Intangible Transition Charges amounts sufficient to recover the following Qualified Transition Expenses which total $1.098 billion:

(a) $607.355 million in Stranded Generation Costs
(b) $372.917 million in Regulatory Assets
(c) $ 96.162 million in Deferred Fuel Costs
(d) $ 21.917 million in Prorata Issuance and Use-of-Proceeds Costs (exclusive of Common Equity Premiums).

6. That PECO Energy Company be, and hereby, is directed to implement a reduction in its customer rates, on the following terms: (a) a rate reduction shall be implemented only upon successful issuance of Transition Bond authorized by this Qualified Rate Order (if issuance is in one or more series, a rate reduction shall be calculated and implemented corresponding to each such series); (b) the aggregate rate reduction shall be in an amount equal to the revenue requirement currently included in the Company's rates for the Transition or Stranded Costs for which Transition Bonds have been issued on that date; (c) for such Transition or Stranded Costs that are currently in the Company's base rates, the Company shall remove from its base rates sufficient revenue requirement such that it will no longer receive either a return of or a return on those investments; (d) for such Transition or Stranded Costs

that are not currently in the Company's base rates, the Company shall be prohibited from recovering in its base rates the revenue requirement associated with amortization of those expenses; (e) for the deferred fuel balances, the Company shall settle those deferred balances; (f) the rate reduction shall be applied to customer bills using the method and allocation set forth in the Company's filing, testimony, exhibits and tariff; and (g) the Intangible Transition Charges associated with the Transition Bonds issued on that date shall be applied to customer bills simultaneously with the rate reduction. This Commission approves the supplements and changes to the Company's Electric Service Tariff, as proposed by the Company in its filing, testimony, and exhibits, to implement this reduction in its customer rates.

7. That this Commission authorizes PECO Energy Company to impose on, and collect from its customers, through non-bypassable charges applied to the bill of every customer accessing the Company's transmission or distribution network, the "Intangible Transition Charges" in an amount equal to $1.098 billion plus an amount sufficient to provide for any credit enhancement and to pay interest, redemption premiums, if any, and servicing expenses relating to the Transition Bonds. The Intangible Transition Charges shall be collected over periods of time and in such amounts as are necessary to amortize each series of Transition Bonds in accordance with the terms thereof. Notwithstanding anything else in this Qualified Rate Order, the Intangible Transition Charges shall be collected from customers until all of the Transition Bonds are discharged.

8. That PECO Energy Company be, and hereby is, directed as follows:

a. To deposit in trust, or other restricted account, any ITC revenues and transition bond proceeds where such funds will not be available for PECO's general corporate use, but shall be invested in short term securities determined to be appropriate by the Transition Bond trustee.

b. To the extent that delays in the use of the ITC revenues or the transition bond proceeds produce float or interest income, that income shall be used to offset security issuance and redemption expenses that will be charged to ratepayers through the ITC.

c. To provide an accounting of the float or interest income and its offset to issuance or redemption expenses in all subsequent reconciliation filings.

9. That this Commission determines that PECO Energy Company's imposition on customers of Intangible Transition Charges in an amount sufficient to recover an aggregate amount of (a) $1.098 billion of Qualified Transition Expenses, comprised of $1.076 billion of the Company's Transition or Stranded Costs under 66 Pa. C.S. §2804 (relating to standards) and 66 Pa. C.S. §2908 (relating to Competitive Transition Charge), $7.116 million in costs relating to the sale of Intangible Property or issuance of Transition Bonds, and $14.801 million in costs associated with the Company's use of the proceeds (including the cost of retiring the Company's debt or equity), plus (b) an amount of Qualified Transition Expenses sufficient to provide for any credit enhancement to pay interest, redemption premiums, if any, and servicing expenses relating to the Transition Bonds in the public interest and is just and reasonable.

10. That the Intangible Transition Charges shall be applied to customer bills using the methodology and allocation set forth in the Company's filing, testimony, exhibits, and Tariff. The Company is directed to file supplements and changes to its Electric Service Tariff consistent with this Qualified Rate Order. Pursuant to 66 Pa. C.S. §2812(b)(5), this Commission authorizes the Company to make annual adjustments to the Intangible Transition Charges to ensure the recovery of revenues sufficient to fully cover the Qualified Transition Expenses consistent with this Commission's Order at Docket No. M-00960890 F.006, entered April 11, 1997. The revenues collected through the Intangible Transition Charges shall be determined to be sufficient for this purpose if and only if the revenues collected through the Intangible Transition Charges are sufficient to amortize the Transition Bonds (after payment of accrued interest and servicing fees) in accordance with the terms thereof and as consistent with the terms of this Qualified Rate Order. For each Annual Adjustment, the Company shall file with this Commission: (a) an accounting of its collections of Intangible Transition Charges for the previous annual period; (b) a statement of any over- or under-collections; (c) the charge or credit to be added to Intangible Transition Charges during the next year to ensure that the Intangible Transition Charges revenue collections will be sufficient to amortize the Qualified Transition Expenses in accordance with the amortization schedule for the principal amount of Qualified Transition Expenses ("Projected QTE Balances"); and (d) any proposal by the Company to modify the reconciliation methodology. Pursuant to 66 Pa. C.S. §2812(b)(5), this Commission shall approve all Annual Adjustments within 90 days of the Company's Annual Adjustment filing.

11. That this Qualified Rate Order authorizes the Company to include as part of its Qualified Transition Expenses $21.917

million in pro rata issuance and use of proceeds costs. The Company shall effect a reconciliation between its estimate of these costs and the actual costs incurred on the following terms: (a) the Company shall establish a tracking account for all expenses incurred related to these estimated costs; (b) when the Company has completed a full accounting of actual costs, it shall file with this Commission supporting documents for those actual costs and shall state the amount by which the actual costs differ from the estimated costs; (c) at the same time, the Company shall file with this Commission a reconciliation of any over- or under-collection of such costs, including the payment or recovery of interest on over- or under-collection balances and (d) this reconciliation shall be implemented through automatic adjustments to the Company's base rates, and not through any Intangible Transition Charges.

12. That this Commission determines that the methodology under which the Company will recover the Intangible Transition Charges authorized by this Qualified Rate Order satisfies the provisions of 66 Pa. C.S. §2812(g), which require that the methodology not shift inter-class or intra-class and that the methodology maintain consistency with the allocation methodology for utility production plant used by the Commission in the Company's last base rate proceeding.

13. That this Commission concludes that it is in the public interest to, and authorizes the Company and any Assignee to (a) assign, sell, transfer or pledge Intangible Transition Property in an amount sufficient to recover all its Qualified Transition Expenses (such term includes all right, title and interest of the Company or any Assignee in this Qualified Rate Order) and in all revenues, collections, claims, payments, money or proceeds arising from Intangible Transition Charges pursuant to this

Qualified Rate Order to the extent this Qualified Rate Order and the rates and other charges authorized hereunder are declared irrevocable and (b) issue, sell and refinance, in reliance on this Qualified Rate Order, one or more series of Transition Bonds, each series with a final maturity of up to ten years, and each series in one or more classes secured by the Intangible Transition Property created by this Qualified Rate Order. The last issuance of Transition Bonds and any accompanying assignment, sale, transfer, or pledge of Intangible Transition Property under this Qualified Rate Order shall be effected within one year from the date of entry of this Qualified Rate Order. Notwithstanding the foregoing, the Company retains sole discretion regarding whether to assign, sell or otherwise transfer Intangible Transition Property created hereby or to issue or cause the Transition Bonds to be issued or refinanced. We also determine that with respect to this timing for issuance of transition bonds, our decision relative to this issue is not irrevocable.

14. That, if the Company or any Assignee refinances the Transition Bonds, the Intangible Transition Charges authorized in this Qualified Rate Order shall be adjusted in accordance with the true-up mechanism described in paragraph 10 of this Qualified Rate Order to ensure the recovery of revenues sufficient to make all interest, redemption premiums, if any, servicing expenses and principal payments with respect to Transition Bonds issued in that refinancing. The revenues collected through the Intangible Transition Charges shall be determined to be sufficient for this purpose if and only if the revenues collected through the Intangible Transition Charges provides for the amortization of Transition Bonds in accordance with any amortization schedule set forth in any prospectus or other offering document provided to the holders of the refinanced bonds.

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15. That this Commission directs that PECO Energy Company use the proceeds from the assignment, sale, transfer or pledge of Intangible Transition Property and the issuance and sale of Transition Bonds principally to reduce the Company's Transition or Stranded Costs and to reduce related capitalization. The Company currently anticipates using, and this Commission hereby authorizes the Company to use, the proceeds from the assignment, sale, transfer or pledge of the Intangible Transition Property created by this Qualified Rate Order as follows: approximately $21.917 million to be used to pay costs of issuing the Transition Bonds and costs associated with the Company's use of the proceeds; approximately $96.162 million to be applied to reduce the Company's deferred fuel costs; and approximately $980.272 million (less any amounts representing required credit enhancement with respect to the Transition Bonds) million to be used to reduce the Company's existing capitalization through retirement of outstanding debt and preferred stock and the return on investment to equity holders through stock buybacks, dividends and market purchases.

16. That the Allegheny Power Settlement submitted on February 27, 1997, be, and hereby is, approved to the extent consistent with this Opinion and Qualified Rate Order.

17. That PECO Energy Company shall file with this Commission, no later than 120 days after the issuance or refinancing of Transition Bonds, a description of the final structure of each issuance or refinancing of such Transition Bonds, including the principal amount, the price at which each such series and/or class of Transition Bonds were sold, payment schedules, the interest rate and other financing costs, and the final plans for the Company's use of the proceeds of such

offering, and in the case of any subsequent refinancing of Transition Bonds specifying the effect upon the rates authorized herein. Notwithstanding such filing, the final structure of each such issuance or refinancing and the related effect on rates authorized herein shall not be subject to change or revision by this Commission after the date of such issuance or refinancing.

18. That, to the extent that the Company, or any Assignee, assigns, sells, transfers, or pledges any interest in the Intangible Transition Property created hereby, this Commission authorizes the Company to contract, for a specified fee, with such Assignee for the Company to continue to operate the system to provide electric service to the Company's customers, to impose and collect the applicable Intangible Transition Charges for the benefit and account of the Assignee, to impose and collect the applicable Intangible Transition Charges for the benefit and account of the Assignee to make periodic adjustments of Intangible Transition Charges contemplated under paragraph 10 of this Qualified Rate Order, and to account for and remit the applicable Intangible Transition Charges to or for the account of the Assignee free of any charge, deduction or surcharge of any kind (other than the specified contractual fee referred to above). This Commission also authorizes the Company to contract with the Assignee and an alternative party, which may be a trustee, that the alternative party will replace the Company under its contract with the Assignee and perform the obligations of the Company contemplated in this Qualified Rate Order. The obligations of the Company (a) shall be binding upon the Company, its successors and assigns and (b) shall be required by this Commission to be undertaken and performed by the Company and any other entity which provides electric service to a person that was a customer of the Company located within the Company's certificated territory on January 1, 1997,

or that became a customer of electric services within such territory after January 1, 1997, and is still located within such territory, as a condition to providing service to such customer or municipal entity providing such services in place of the Company by the Company or other entity.

19. That this Commission hereby declares that this Qualified Rate Order shall be irrevocable for purposes of Section 2812 of the Public Utility Code, 66 Pa. C.S. §2812, and accordingly agrees that it will not directly or indirectly, by any subsequent action, reduce, postpone, impair or terminate this Qualified Rate Order or the rates and other charges authorized hereby, including, without limitation, the Intangible Transition Charges, until the Transition Bonds are fully paid and discharged. This Commission further declares that the right, title and interest of the Company and any Assignee in this Qualified Rate Order and the Intangible Transition Charges, the rates and other charges authorized hereby and all revenues, collections, claims, payments, money or proceeds of or arising from the same constitutes Intangible Transition Property. To the extent that an assignment, sale or transfer of the Intangible Transition Property resulting from this Qualified Rate Order, or the issuance of related Transition Bonds, is not affected within the period specified in paragraph 13 of this Qualified Rate Order, the provisions of this paragraph shall lapse and terminate; *provided, however*, that this Commission, through subsequent application by the Company, may reinstate the irrevocability of the whole of or any portion of this Qualified Rate Order.

20. That, in this Qualified Rate Order, this Commission authorizes the recovery of $1.076 billion of the Company's Transition or Stranded Costs. In accordance with 66 Pa. C.S.

§2812(b)(5)(i), this Commission makes no determination in this Qualified Rate Order regarding the Company's recovery of Transition or Stranded Costs above that $1.076 billion amount. The Commission hereby directs that the Company may, by subsequent application or applications, request this Commission to consider additional Qualified Transition Expenses and other issuances of Transition Bonds. This Commission defers consideration of any such request until such time as the Company submits such additional applications for qualified rate orders.

21. That during some or all of the period during which the Intangible Transition Charges approved by this Qualified Rate Order are being collected, the generation component of the Company's charges to customers will be limited by the provisions of 66 Pa. C.S. §2804(4) (pertaining to rate caps). For purposes of 66 Pa. C.S. §2804(4)(ii), the generation component of the Company's charges includes Competitive Transition Charges, Intangible Transition Charges, and other generation charges. In the event that the combined total of these elements would cause the generation component of the Company's charges to exceed the rate cap specified in 66 Pa. C.S. §2804(4), the Company shall retain whatever right it may have under the existing provisions of the statute to request relief from the rate cap, but in the event that it does not seek such relief or that relief is denied, the Company shall adjust the non-securitized elements of its generation charges, rather than the Intangible Transition Charges approved by this Qualified Rate Order, to bring the charges into compliance with the rate cap provisions of 66 Pa. C.S. §2804(4).

22. That all matters not specifically disposed of in this Qualified Rate Order, are deferred to the proceeding on PECO

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Energy Company's restructuring application, Docket No. R-00973953.

BY THE COMMISSION

s/ John G. Alford
John G. Alford
Secretary

(SEAL)

ORDER ADOPTED: May 22, 1997

ORDER ENTERED: MAY 22 1997

Appendix C

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

PUBLIC MEETING —
MAY 22, 1997
MAY-97-OSA-180*
DOCKET NO. R-00973877

APPLICATION OF PECO ENERGY COMPANY FOR ISSUANCE OF A QUALIFIED RATE ORDER UNDER SECTIONS 2808 AND 2812 OF THE PUBLIC UTILITY CODE

DISSENTING OPINION OF COMMISSIONER DAVID W. ROLKA

I respectfully dissent from the majority's decision to issue an irrevocable Qualified Rate Order (QRO) pertaining to any generation assets at this time. Instead, I submit that the Commission's decision to issue a Qualified Rate Order relating to generation assets should be revocable. I do not believe that the "known and measurable" evidentiary standard prescribed by statute has been met. Moreover, I disagree with the procedural decision to refrain from declaring that the record in this proceeding should be incorporated into PECO Energy's pending restructuring proceeding. The majority's decision imposes needless additional administrative burden on parties whose resources are already constrained.

This case is the first of its kind to have come before the Office of Administrative Law Judge of the Pennsylvania PUC and before this Commission. To my knowledge, not since 1979, has the Commission been confronted with the prospect of

removing utility assets from traditional base rates (*Pennsylvania Public Utility Commission., et al. v. Metropolitan Edison Company and Pennsylvania Electric Company*, Docket No. I-79040308, June 15, 1979). At that time the decision of the Commission was simplified by stipulation of the parties to the use of the test years in the Respondent's last rate cases (then less than one year stale) and the incorporation of those records by reference into the then present record. That proceeding was further simplified by the absence of any attempt by any of the parties to introduce specific evidence of changes in fair value or fair rate of return. Additionally, the Respondents waived a redetermination of their capital structure and rate of return for purposes of that proceeding.

Few, if any, of those simplifications even arguably exist in this proceeding. Unlike the proceeding that unfolded in 1979, however, this Section 2812 proceeding does have the advantage of being 'pancaked' on top of a restructuring proceeding and our results here need not finally adjudicate every issue.

Irrevocability of the Qualified Rate Order

The determination to grant irrevocable status to some or all of this securitization is an issue separate and apart from the issue of determining whether to grant a QRO under Section 2812(b)(4). No specific standard is prescribed in Section 2812 to govern the PUC's exercise of discretion to make an irrevocability decision. Accordingly, the statutory standards governing the threshold decision to issue a QRO, as set forth in Sections 2812(A)(2)(III) and 2812(B)(1)(I), must be applied to the irrevocability decision. The standard must be whether irrevocable status is in conformance with the "just and reasonable" standard, (66 Pa. C.S. §1301) and whether the grant of irrevocable status is in the public interest.

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The Legislature has determined that certain transition costs and stranded costs, defined in Sections 2803 and 2808, may be recovered as part of the transition to a competitive market in electric generation and constitute costs which are just and reasonable. The definition of "transition or stranded costs" in Section 2803 mandates that such costs be (1) known and measurable; (2) determined on a net present value basis over the life of the asset or liability; (3) traditionally would be recoverable under a regulated environment; but which may not be recoverable in a competitive electric generation environment; and, (4) be determined by the Commission to remain following mitigation by the electric utility.

In considering how the public interest is served as part of the Commission's review of a request for a QRO, the Commission must also determine whether QRO irrevocability produces net benefits, considering the risks, over a revocable QRO. Such benefits should be judged not from the perspective of the issuer or purchaser of transition bonds (for which the benefits are obvious), but from the perspective of the ratepayers who will be obligated to finance the full costs of such bonds. Comparison must be made of the relative costs and risks of revocable and non-revocable QROs.

Thus the Commission's decision on granting irrevocable status must depend on the quality and certainty of the evidence before it. Whereas the Commission may base its decision upon substantial evidence, most of the issues in a QRO proceeding are based wholly or partly upon estimates of costs, future prices, future interest rates and the success of future efforts at mitigation. The Commission would ordinarily be able to rely on the best available estimates, knowing that such estimates are subject to correction by actual experience and that it would

be able to make corrections if reality later sharply departed from estimated data. Irrevocability prevents such corrections for all time, and locks the Commission and the ratepaying public into estimates of costs that are by their very nature fraught with a degree of uncertainty.

The principal benefit of irrevocability is that it reduces the cost of ITC transition bonds by reducing the bondholders' risk of non-payment to the maximum extent possible. In order to determine whether the risks of irrevocability are worth the benefits, the Commission must be able to satisfy itself with a high degree of certainty. Achieving a high degree of certainty involves at least three considerations. First, the estimates of qualified transition expenses and stranded costs must be reliable and not unduly speculative. Second, irrevocable ITC transition bonds must be less expensive than traditional financing by an extent great enough to offset the greater risk to the public that it might, in the future, be called upon to pay an ITC based upon estimates of qualified transition expenses and stranded costs which are grossly excessive and, therefore, unjust and unreasonable. Third, the public interest must be served by the Commission's acceptance, on behalf of the Commonwealth and its ratepayers, of a reasonable risk and not an excessive risk based upon unduly speculative or variable data.

Therefore, in order to assure that the "just and reasonable rate standard" is met, and to assure that the public interest is served, the Commission should not grant irrevocable status to all or any portion of a securitization unless it believes that the decision is based upon a record which demonstrates a level of qualified transition expenses and stranded costs which are reasonably known and certain, and which will result in financing costs which are significantly lower then traditional financing,

at least to the extent that they compensate the public for the increased risk they assume. The Commission should not make irrevocable decisions in this expedited proceeding that a more fully developed record could later prove unwise, just to begin a securitization proposal a few months earlier than would otherwise be permitted.

I do not believe that the "known and measurable" standard has been sufficiently demonstrated. Because of this concern, I would issue a Qualified Rate Order which was *revocable* for securitization of that portion of the generation assets identified in the majority's decision, and *irrevocable* for securitization of that portion of the regulatory assets identified in the majority's decision. Such a decision would provide a more moderate response to PECO Energy's application, and would provide the needed flexibility to make adjustments, if called for, at the conclusion of PECO's restructuring proceeding.

My concern over the level of uncertainty concerning the quantification of PECO Energy's generation assets, and the amount which may be stranded, appears to have been confirmed by a report prepared by our Bureau of Audits that will be publicly released today. The auditors believe that PECO's books and records contain accounting entries for plant investment and equipment that is no longer useful in utility operations. (See Docket No. D-97S001; Public Meeting agenda item MAY-97-A-19). I recognize that these staff findings are not binding on the Commission and are not part of the record in this proceeding. The report, however, points out what additional information may be available for consideration in the restructuring proceeding to assist the agency in deciding the level of PECO Energy's stranded costs in a manner that meets the "known and measurable" standard of the statute.

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The "bottom line" question is: do we know enough to conclude that PECO Energy's market value models produce accurate results? If the answer is no, then I cannot grant irrevocable relief because the known and measurable standard cannot be met. The ALJ'S analytical framework setting forth the various deficiencies of the models and his ultimate rejection thereof, was crisp, clear, well reasoned, and I agree.

Incorporation of the Record of this Proceeding Into the Restructuring Proceeding

The Administrative Law Judge recommended that the record in this proceeding be incorporated into the record of the restructuring proceeding pending at Docket No. R-973953. Particularly given the number of issues that have been deferred from this proceeding to the restructuring proceeding, and the interrelationship of the various issues considered herein and to be considered in the restructuring proceeding, judicial economy counsels that the ALJ's recommendation be adopted. Instead the majority decision requires that parties designate those portions of the record that they want to have included in the restructuring proceeding. Such a requirement is time consuming and unnecessarily onerous. It requires less administrative oversight and burden to simply incorporate all of the record of this proceeding, and I can discern no prejudice to any of the parties. This may seem like a minor point now, but with the crunch of litigation deadlines facing all of the parties to the restructuring proceeding, this procedural decision imposes a tedious and otherwise avoidable task.

5-22-97
DATED

s/ David W. Rolka
DAVID W. ROLKA, COMMISSIONER

Appendix C

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105

PUBLIC MEETING —
MAY 8, 1997
MAY-97-OSA-159*
DOCKET NO. R-00973877

APPLICATION OF PECO ENERGY COMPANY FOR ISSUANCE OF A QUALIFIED RATE ORDER UNDER SECTIONS 2808 AND 2812 OF THE PUBLIC UTILITY CODE

STATEMENT OF CHAIRMAN JOHN M. QUAIN

On January 22, 1997, PECO Energy Company (PECO) filed an expedited request for securitization of certain costs stranded by the move to competition. This is the first such securitization request submitted pursuant to the Electricity Generation Customer Choice and Competition Act (Act).

By law, my colleagues and I were required to refrain from discussing the merits of the case as of the date it was filed. The level of media interest in this request, and the mischaracterizations made by some, regarding both this filing and the Act itself, made silence difficult to maintain over the last three months. As of today, however, I am no longer required to remain silent.

Initially, I wish to correct some of those mischaracterizations. First, in my view, the Electricity Generation Customer Choice and Competition Act holds enormous promise for Pennsylvania. I fully recognize, however,

that as we move to greater competition, many complex and controversial issues must be decided.

This filing represents the first such issue. It is important to keep in mind, however, that at worst, it represents a rate *reduction*. The only question is: by how much? Given the fact that PECO has not had a base rate *reduction* in over twenty years, this is not a bad place to begin implementation of the new law.

Second, much has been made of the fact that any costs securitized will remain on customer bills for ten years. Critics, however, conveniently ignore the fact that absent this landmark legislation, such costs would remain on customer bills for the next *twenty to thirty* years. Thus, the amount securitized through our action today will *reduce* the time PECO will be permitted to recover costs from its customers.

Third, this case is not, as some would describe it, an opportunity for a rate *increase*. The rate cap imposed by Section 2804 of the Act prohibits such a result. In fact, PECO's rate cap resulted in customers avoiding a $125 million rate increase last December. Again, this fact has been overlooked by those who ignore the benefits generated by the Act.

Next, I wish to address our ability to render this decision within the time frame prescribed by law. I am concerned with the comments which suggest that we should favor bureaucratic tradition over legislative intent. Such suggestions are without merit; they have no basis in business reality.

Pursuant to Section 2812 of the Act, expedited requests for securitization *must* be decided within 120 days. That is the

law! That is the time frame approved by the Governor and the General Assembly of Pennsylvania. It is not within the province of this Commission to question the propriety of this time frame.

Moreover, let me state without equivocation that this Commission stands ready to implement all provisions of the Act in a timely and professional manner. For example, over the past 120 days (a time frame considered by many to be too short) this agency has begun implementation of the Act by issuing 20 separate orders; has conducted 10 public forums and; conducted 5 audits. Today we will issue an additional 6 orders and approve our first 3 licenses for competitive providers. This activity demonstrates a high level of professionalism by our staff and others participating in the process. Consequently, those who yearn for the, "good old days" when the bureaucracy, rather than the public interest and the market, defined the timeliness for decisions, should look elsewhere for a sympathetic ear.

I take strong exception to the suggestion that our staff, the industry and other interested parties are not up to the challenges posed by the Act. While I sit as a Commissioner of this agency and am privileged to act as its Chairman, we will not shrink from our responsibilities; nor will we make excuses that the demands of the law are too onerous.

5-8-97
DATE

s/ John M. Quain
JOHN M. QUAIN, CHAIRMAN

Appendix C

PENNSYLVANIA PUBLIC UTILITY COMMISSION
Harrisburg, Pennsylvania 17105-3265

PUBLIC MEETING —
MAY 22, 1997
MAY-97-OSA-180*
DOCKET NO. R-00973877

APPLICATION OF PECO ENERGY COMPANY FOR A QUALIFIED RATE ORDER UNDER SECTIONS 2806 AND 2812 OF THE PUBLIC UTILITY CODE

STATEMENT OF COMMISSIONER JOHN HANGER

INTRODUCTION

As I stated at the May 8th Public Meeting, this case starts the process of determining how much the electric rates of PECO Energy Company ("PECO") will go down. PECO's position in this case would reduce its electric rates by 3.4%. Other parties insist that PECO's rate decrease is not nearly enough, since rates would fall approximately 40% if PECO's customers received now the full benefits of electric generation competition made possible by the Electricity Generation Customer Choice and Competition Act ("Act"). Consequently, though the parties have raised many issues, the bottom line of this case is argument about the amount that PECO's rates will be cut and when rates will be cut.

For this Commission, deciding cases about how much electric rates should be decreased is a novel experience. In just the four years prior to the passage of the Act, this Commission adjudicated 6 electric base rate increase cases that were filed

by four of Pennsylvania's electric utilities. In all 6 cases, an electric rate increase of some amount was a foregone conclusion. Fortunately, given the new policy of electric generation competition, electric rate increase cases are at least an endangered species, if not extinct. The Commission's new mission is to judge passionate disagreements about the appropriate level and timing of rate decreases.

DISCUSSION

On May 8th, I issued a lengthy statement that explained the basis for my decision in this case. I will now only summarize briefly the reasons for my decision and refer those interested in more detail to my May 8th statement.

PECO alleges it has $6.8 billion of stranded investment in uneconomic plants. These stranded costs are presently in rates and ratepayers are now paying 100% of these costs when they pay their monthly electric bills.

Of PECO's $6.8 billion of alleged stranded investment, PECO petitions in this case for a Qualified Rate Order that would allow it to securitize $3.773 billion of expenses. If approved, PECO's Petition would securitize 68% of its stranded generating plant claim and 50% of its stranded regulatory assets.

Numerous parties challenge PECO's Petition on even more numerous grounds. Some parties urge that legal reasons justify denying entirely PECO's Petition. Still other parties such as the Office of Consumer Advocate (OCA) and the Philadelphia Area Industrial Energy Users Group (PAIEUG) factually challenge substantial portions of PECO's request but do recommend that this Commission authorize securitization of a

part of the $3.773 billion for which PECO petitions. Many of these parties argue that disallowance of some, most, or all of PECO's total stranded investment claim will reduce rates much more than the securitization of some, most, or all of PECO's stranded investment claim.

For the reasons that I set forth on May 8th, PECO's Petition to securitize $3.773 billion should be denied. Alternatively, the record of this case supports allowing PECO securitize $1.098 billion. This alternative recommendation is based upon the factual adjustments to PECO's Petition that OCA and PAIEUG make.

Concerning stranded regulatory assets, the Office of Consumer Advocate recommends approval of $514 million. I accept the OCA adjustments to PECO's stranded regulatory claim but modify it to reflect the December 31, 1998 balance of the approved assets. This modification leads to approval of $469 million of stranded regulatory assets for securitization.

Concerning stranded generating plant, I accept the factual adjustments to PECO's Petition made by PAIEUG. After making its adjustments, PAIEUG recommends securitization of $607 million. This recommendation should be adopted.

Today's Proposed Order reflects the OCA's adjustments to PECO's regulatory assets claim and the PAIEUG adjustments to stranded generating investment. The Proposed Order allows PECO to securitize 16% of its total stranded generating claim of $3.566 billion and 14% of its stranded regulatory claim of $2.636 billion.

Appendix C

CONCLUSION

It is my duty to weigh the evidence, make only determinations that are supported by substantial evidence, and to balance the interests of all parties, including those of shareholders and ratepayers. The Proposed Order allows PECO to securitize significantly less than the $3.773 billion it requested, but the Order's factual findings are supported by substantial evidence and reasonably balance the interests of shareholders and ratepayers. Furthermore, the Proposed Order defers to PECO's general restructuring case most of the thorny questions, including most of the stranded investment issues.

Lastly, though some may still incorrectly believe that today's Order will raise rates for PECO's customers, that is not true. One hundred percent of PECO's stranded investment is in rates charged to ratepayers today. This decision, therefore, does not create any new or added costs for ratepayers. In fact, securitization will allow refinancing of some existing investments in order to reduce the capital or interest costs that are now charged to ratepayers. Moreover, those parties that wish to argue that some or most of PECO's stranded investment should be disallowed instead of securitized may do so in PECO's pending restructuring filing.

[illegible] s/ John Hanger
DATE **JOHN HANGER, COMMISSIONER**

APPENDIX D — ORDER OF THE SUPREME COURT OF PENNSYLVANIA, MIDDLE DISTRICT DENYING PETITION FOR ALLOWANCE OF APPEAL DATED SEPTEMBER 29, 1998 AND FILED OCTOBER 1, 1998

IN THE SUPREME COURT OF PENNSYLVANIA
MIDDLE DISTRICT

No. 435 M.D. Allocatur Docket, 1998

INDIANAPOLIS POWER & LIGHT COMPANY,

Petitioner

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,

Respondent

PECO ENERGY COMPANY,

Intervenor

Petition for Allowance of Appeal from the Commonwealth Court.

ORDER

PER CURIAM:

AND NOW, this 29th day of September, 1998 the petition for allowance of appeal is denied.

[stamp]
TRUE & CORRECT COPY

ATTEST:
OCT 1 1998

s/ Shirley Bailey
SHIRLEY BAILEY
CHIEF CLERK

APPENDIX E — ELECTRICITY GENERATION CUSTOMER CHOICE AND COMPETITION ACT 66 PA. C.S.A. §§ 2801-2812

§ 2801. Short title of chapter

This chapter shall be known and may be cited as the Electricity Generation Customer Choice and Competition Act.

* * *

§ 2802. Declaration of policy

The General Assembly finds and declares as follows:

(1) Over the past 20 years, the Federal Government and State government have introduced competition in several industries that previously had been regulated as natural monopolies.

(2) Many state governments are implementing or studying policies that would create a competitive market for the generation of electricity.

(3) Because of advances in electric generation technology and Federal initiatives to encourage greater competition in the wholesale electric market, it is now in the public interest to permit retail customers to obtain direct access to a competitive generation market as long as safe and affordable transmission and distribution service is

available at levels of reliability that are currently enjoyed by the citizens and businesses of this Commonwealth.

(4) Rates for electricity in this Commonwealth are on average higher than the national average, and significant differences exist among the rates of Pennsylvania electric utilities.

(5) Competitive market forces are more effective than economic regulation in controlling the cost of generating electricity.

(6) The cost of electricity is an important factor in decisions made by businesses concerning locating, expanding and retaining facilities in this Commonwealth.

(7) This Commonwealth must begin the transition from regulation to greater competition in the electricity generation market to benefit all classes of customers and to protect this Commonwealth's ability to compete in the national and international marketplace for industry and jobs.

(8) In moving toward greater competition in the electricity generation market, the Commonwealth must resolve certain transitional issues in a manner that is fair to customers, electric utilities, investors, the employees of electric utilities, local

communities, nonutility generators of electricity and other affected parties.

(9) Electric service is essential to the health and well-being of residents, to public safety and to orderly economic development, and electric service should be available to all customers on reasonable terms and conditions.

(10) The Commonwealth must, at a minimum, continue the protections, policies and services that now assist customers who are low-income to afford electric service.

(11) In order to ensure the safety and reliability of the electric system, ensure the continued provision of high-quality customer service and avoid economic dislocation, utilities shall consider the experience and expertise of their work force in moving towards competition.

(12) The purpose of this chapter is to modify existing legislation and regulations and to establish standards and procedures in order to create direct access by retail customers to the competitive market for the generation of electricity while maintaining the safety and reliability of the electric system for all parties. Reliable electric service is of the utmost importance to the health, safety and welfare of the citizens of the Commonwealth. Electric industry restructuring should ensure the

reliability of the interconnected electric system by maintaining the efficiency of the transmission and distribution system.

(13) Under current law and regulation there exists some competition in the wholesale market for the generation of electricity, but the generation, transmission, distribution and retail sale of electricity is provided generally by public utilities under bundled rates regulated by the commission. The procedures established under this chapter provide for a fair and orderly transition from the current regulated structure to a structure under which retail customers will have direct access to a competitive market for the generation and sale or purchase of electricity.

(14) This chapter requires electric utilities to unbundle their rates and services and to provide open access over their transmission and distribution systems to allow competitive suppliers to generate and sell electricity directly to consumers in this Commonwealth. The generation of electricity will no longer be regulated as a public utility function except as otherwise provided for in this chapter. Electric generation suppliers will be required to obtain licenses, demonstrate financial responsibility and comply with such other requirements concerning service as the commission deems necessary for the protection of the public.

(15) In establishing the standards for the transition to and creation of a competitive electric market, heretofore, public utilities generally have had an obligation to serve customers within their defined service territories; consistent with that obligation, have undertaken long-term investments in generation, transmission and distribution facilities in order to meet the needs of their customers; and have entered into long-term power supply agreements as required by Federal law. In many instances, these investments and agreements have created costs which may not be recoverable in a competitive market. The commission is empowered under this chapter to determine the level of transition or stranded costs for each electric utility and to provide a mechanism, the competitive transition charge, for recovery of an appropriate amount of such costs in accordance with the standards established in his chapter.

(16) It is in the public interest for the transmission and distribution of electricity to continue to be regulated as a natural monopoly subject to the jurisdiction and active supervision of the commission. Electric distribution companies should continue to be the provider of last resort in order to ensure the availability of universal electric service in this Commonwealth unless another provider of last resort is approved by the commission.

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(17) There are certain public purpose costs, including programs for low-income assistance, energy conservation and others, which have been implemented and supported by public utilities' bundled rates. The public purpose is to be promoted by continuing universal service and energy conservation policies, protections and services, and full recovery of such costs is to be permitted through a nonbypassable rate mechanism.

(18) There are certain changes to a utility which will create transition costs to accomplish the move to a competitive market. These changes may entail the closure of facilities or reduction in employee levels. If such actions are to be undertaken, the utility must fully inform the commission of the impact of such decisions on local communities and on social services and of any tax implications of the actions. The utility is expected to discuss the transition to competition with its employees or their certified representatives and may provide severance, retraining, early retirement and outplacement services. Such transition costs may be recoverable under the competitive transition charge in section 2808 (relating to competitive transition charge).

(19) All participants in the restructured electric industry are encouraged to coordinate their plans and transactions through an independent system operator or its functional equivalent.

(20) Since continuing and ensuring the reliability of electric service depends on adequate generation and on conscientious inspection and maintenance of transmission and distribution systems, the independent system operator or its functional equivalent should set, and the commission shall set through regulations, inspection, maintenance, repair and replacement standards and enforce those standards.

(21) Under Federal and State clean air laws and regulations, electricity generators located in states to the west and south of this Commonwealth are not subject to requirements as stringent as those which apply to generators and other "persons" as defined in section 3 of the act of January 8, 1960 (1959 P.L. 2119, No. 787),[1] known as the Air Pollution Control Act, operating in this Commonwealth and that different regions within this Commonwealth are subject to varying air emission requirements. Under some scenarios, competition among electricity generators located in different states and different regions within this Commonwealth could make it more difficult for areas in this Commonwealth to demonstrate attainment with Federal and State air quality standards. Since this result may be caused by the disparate requirements imposed by Federal and State law on generators and other "persons" as defined in section 3 of the

1. 35 P.S. § 4003.

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Air Pollution Control Act in this Commonwealth and generators located in other areas, the General Assembly supports changes to Federal clean air laws and regulations that will protect Pennsylvania's environment and ensure that electricity generators and other "persons" as defined in section 3 of the Air Pollution Control Act located in this Commonwealth are not placed at an undue competitive disadvantage. The commission will consult with the Department of Environmental Protection regarding the issue during the transition to retail competition.

* * *

§ 2803. Definitions.

The following words and phrases when used in this chapter shall have the meanings given to them in this section unless the context clearly indicates otherwise:

"Aggregator" or **"market aggregator."** An entity, licensed by the commission, that purchases electric energy and takes title to electric energy as an intermediary for sale to retail customers.

"Broker" or **"marketer."** An entity, licensed by the commission, that acts as an agent or intermediary in the sale and purchase of electric energy but that does not take title to electric energy.

"Competitive transition charge." A nonbypassable charge applied to the bill of every customer accessing

the transmission or distribution network which (charge) is designed to recover an electric utility's transition or stranded costs as determined by the commission under sections 2804 (relating to standards for restructuring of electric industry) and 2808 (relating to competitive transition charge).

"Consumer." A retail electric customer.

"Customer." A retail electric customer.

"Direct access." The right of electric generation suppliers and end-use customers to utilize and interconnect with the electric transmission and distribution system on a nondiscriminatory basis at rates, terms and conditions of service comparable to the transmission and distribution companies' own use of the system to transport electricity from any generator of electricity to any end-use customer.

"Electric distribution company." The public utility providing facilities for the jurisdictional transmission and distribution of electricity to retail customers, except building or facility owners/operators that manage the internal distribution system serving such building or facility and that supply electric power and other related electric power services to occupants of the building or facility.

"Electric generation supplier" or **"electricity supplier."** A person or corporation, including municipal corporations which choose to provide service outside their municipal limits except to the extent

provided prior to the effective date of this chapter, brokers and marketers, aggregators or any other entities, that sells to end-use customers electricity or related services utilizing the jurisdictional transmission or distribution facilities of an electric distribution company or that purchases, brokers, arranges or markets electricity or related services for sale to end-use customers utilizing the jurisdictional transmission and distribution facilities of an electric distribution company. The term excludes building or facility owner/operators that manage the internal distribution system serving such building or facility and that supply electric power and other related power services to occupants of the building or facility. The term excludes electric cooperative corporations except as provided in 15 Pa.C.S. Ch. 74 (relating to generation choice for customers of electric cooperatives).

"End-use customer." A retail electric customer.

"Reliability." Includes adequacy and security. As used in this definition "adequacy" means the provision of sufficient generation, transmission and distribution capacity so as to supply the aggregate electric power and energy requirements of consumers, taking into account scheduled and unscheduled outages of system facilities; and "security" means designing, maintaining and operating a system so that it can handle emergencies safely while continuing to operate.

"Renewable resource." Includes technologies such as solar photovoltaic energy, solar thermal energy, wind power, low-head hydropower, geothermal energy,

landfill and mine-based methane gas, energy from waste and sustainable biomass energy.

"Retail customer." A retail electric customer.

"Retail electric customer." A direct purchaser of electric power. The term excludes an occupant of a building or facility where the owners/operators manage the internal distribution system serving such building or facility and supply electric power and other related power services to occupants of the building or facility; where such owners/operators are direct purchasers of electric power; and where the occupants are not direct purchasers.

"Transition or stranded costs." An electric utility's known and measurable net electric generation-related costs, determined on a net present value basis over the life of the asset or liability as part of its restructuring plan, which traditionally would be recoverable under a regulated environment but which may not be recoverable in a competitive electric generation market and which the commission determines will remain following mitigation by the electric utility. The term includes:

(1) Regulatory assets and other deferred charges typically recoverable under current regulatory practice, the unfunded portion of the utility's projected nuclear generating plant decommissioning costs and cost obligations under contracts with nonutility generating projects which have received a commission

order, the recoverability of which shall be determined under section 2808(c)(1) (relating to competitive transition charge).

(2) Prudently incurred costs related to cancellation, buyout, buydown or renegotiation of nonutility generating projects consistent with section 527 (relating to cogeneration rules and regulations), the recoverability of which shall be determined pursuant to section 2808(c)(2).

(3) The following costs, the recoverability of which shall be determined pursuant to section 2808(c)(3):

(i) Net plant investments and costs attributable to the utility's existing generation plants and facilities.

(ii) The utility's disposal of spent nuclear fuel.

(iii) The utility's long-term purchase power commitments other than the costs defined in paragraphs (1) and (2).

(iv) Retirement costs attributable to the utility's existing generating plants other than the costs defined in paragraph (1).

> (v) Other transition costs of the utility, including costs of employee severance, retraining, early retirement, outplacement and related expenses, at reasonable levels, for employees who are affected by changes that occur as a result of the restructuring of the electric industry occasioned by this chapter.

The term includes any costs attributable to physical plants no longer used and useful because of the transition to retail competition. The term excludes any amounts previously disallowed by the commission as imprudently incurred. To the extent that the recoverability of amounts that are sought to be included as transition or stranded costs are subject to appellate review as of the time of the commission determination, any determination to include such costs shall be reversed to the extent required by the results of that appellate review.

"Transmission and distribution costs." All costs directly or indirectly incurred to provide transmission and distribution services to retail electric customers. This includes the return of and return on facilities and other capital investments necessary to provide transmission and distribution services and associated operating expenses, including applicable taxes.

"Universal service and energy conservation." Policies, protections and services that help low-income customers to maintain electric service. The term

includes customer assistance programs, termination of services protection and policies and services that help low-income customers reduce or manage energy consumption in a cost-effective manner, such as the low-income usage reduction programs, application of renewable resources and consumer education.

* * *

§ 2804. Standards for restructuring of electric industry

The following interdependent standards shall govern the commission's assessment and approval of each public utility's restructuring plan, oversight of the transition process and regulation of the restructured electric utility industry:

(1) The commission shall ensure continuation of safe and reliable electric service to all consumers in the Commonwealth, including:

(i) The maintenance of adequate reserve margins by electric suppliers in conformity with the standards required by the North American Electric Reliability Council (NERC) and the regional reliability council appropriate to each supplier, or any successors to those reliability entities, and in conformity with established industry standards and practices.

(ii) The installation and maintenance of transmission and distribution facilities in conformity with established industry standards and practices, including the standards set forth in the National Electric Safety Code.

(2) Consistent with the time line set forth in section 2806 (relating to implementation, pilot programs and performance-based rates), the commission shall allow customers to choose among electric generation suppliers in a competitive generation market through direct access. Customers should be able to choose among alternatives such as firm and interruptible service, flexible pricing and alternate generation sources, including reasonable and fair opportunities to self-generate and interconnect. These alternatives may be provided by different electric generation suppliers.

(3) The commission shall require the unbundling of electric utility services, tariffs and customer bills to separate the charges for generation, transmission and distribution. The commission may require the unbundling of other services.

(4) The following caps on electric utility rates shall apply:

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(i) For a period of 54 months from the effective date of this chapter or until an electric distribution utility is no longer recovering its transition or stranded costs through a competitive transition charge or intangible transition charge and all the customers of an electric distribution utility can choose an alternative provider of electric generation, whichever is shorter:

(A) The total charges of an electric distribution utility for service to any customer who purchases generation from that utility shall not exceed the total charges that have been approved by the commission for such service as of the effective date of this chapter; and

(B) For customers who purchase generation from a supplier other than the electric distribution utility, the charges of the utility for non-generation services that are regulated as of the effective date of this chapter, exclusive of the competitive transition charge and intangible

transition charge, shall not exceed the non-generation charges that have been approved by the commission for such service as of the effective date of this chapter.

(ii) In addition to the rate cap set forth in subparagraph (i), for a period of nine years from the effective date of this chapter or until an electric distribution utility is no longer recovering its transition or stranded costs through a competitive transition charge or intangible transition charge and all customers of an electric distribution utility can choose an alternative provider of electric generation, whichever is shorter, the generation component of a utility's charges to customers who purchase generation from the utility, including the competitive transition charge and intangible transition charge, shall not exceed the generation component charged to the customers that has been approved by the commission for such service as of the effective date of this chapter.

(iii) An electric distribution utility may seek, and the commission may approve, an exception to the

limitations set forth in subparagraphs (i) and (ii) only in any of the following circumstances:

(A) The electric distribution utility meets the requirements for extraordinary rate relief under section 1308(e) (relating to voluntary changes in rates).

(B) Either the electric distribution utility is required to begin payment under contracts with nonutility generation projects that have received commission orders, has been unable to mitigate such costs, such costs are not recoverable in a competitive generation market and such costs were not previously covered in the competitive transition charge or intangible transition charge, or the utility prudently incurs costs related to cancellation, buyout, buydown or renegotiation of nonutility generating project obligations of the utility consistent with section 527 (relating to cogeneration rules and regulations) and such costs were not previously

covered in the competitive transition charge or intangible transition charge. Costs related to cancellation, buyout, buydown or renegotiation shall be recovered from ratepayers over a period not to exceed three years, unless the commission determines within its discretion to require a longer recovery period due to the magnitude of such costs, but shall be accounted for by the utility on a levelized basis over the total period in which the generation portion of the utility's rates are capped.

(C) Either the electric distribution utility is subject to significant increases in the rates of Federal or State taxes or other significant taxes or other significant changes in law or regulations that would not allow the utility to earn a fair rate of return.

(D) The electric distribution utility is subject to significant increases in the unit rate of fuel for utility generation or the price of purchased power

that are outside of the control of the utility and that would not allow the utility to earn a fair rate of return.

(E) The electric distribution utility is directed by the commission or an independent system operator or its functional equivalent to make expenditures to repair or upgrade its transmission or distribution system.

(F) The electric distribution utility seeks to increase its allowance for nuclear decommissioning costs to reflect new information not available at the time the utility's existing rates were determined, and such costs are not recoverable in the competitive generation market and are not covered in the competitive transition charge or intangible transition charge, and such costs would not allow the utility to earn a fair rate of return.

(G) As permitted by paragraph (16).

(iv) Consistent with the requirements of due process, the commission may expedite proceedings that invoke the provisions of subparagraph (iii).

(v) If an electric distribution utility rolls its energy cost rate into base rates at a combined level that does not exceed its combined level of such rates which have been approved by the commission as of the effective date of this chapter, the utility shall not be required to reduce its capped rates below the capped level upon the complaint of any party if the commission determines that any excess earnings achieved under the cap are being utilized to mitigate transition or stranded costs for the benefit of ratepayers or to offset other known and measurable costs increases that would be recoverable under traditional ratemaking but are not included within the capped rates.

(vi) This paragraph shall not apply to new services offered for the first time after the effective date of this chapter.

(5) The commission may permit, but shall not require, an electric utility to divest itself

of facilities or to reorganize its corporate structure.

(6) Consistent with the provision of section 2806, the commission shall require that a public utility that owns or operates jurisdictional transmission and distribution facilities shall provide transmission and distribution service to all retail electric customers in their service territory and to electric cooperative corporations and electric generation suppliers, affiliated or nonaffiliated, on rates, terms of access and conditions that are comparable to the utility's own use of its system.

(7) The commission shall require that restructuring of the electric utility industry be implemented in a manner that does not unreasonably discriminate against one customer class to the benefit of another.

(8) The commission shall establish for each electric utility an appropriate cost-recovery mechanism which is designed to fully recover the electric utility's universal service and energy conservation costs over the life of these programs.

(9) The commission shall ensure that universal service and energy conservation policies, activities and services are appropriately funded and available in each electric distribution territory. Policies,

activities and services under this paragraph shall be funded in each electric distribution territory by nonbypassable, competitively neutral cost-recovery mechanisms that fully recover the costs of universal service and energy conservation services. The commission shall encourage the use of community-based organizations that have the necessary technical and administrative experience to be the direct providers of services or programs which reduce energy consumption or otherwise assist low-income customers to afford electric service. Programs under this paragraph shall be subject to the administrative oversight of the commission which will ensure that the programs are operated in a cost-effective manner.

(10) The commission shall establish rates for jurisdictional transmission and distribution services and shall continue to regulate distribution services for new and existing customers in accordance with this chapter and Chapter 13 (relating to rates and rate making).

(11) The time line for the transition to and phase in of direct access to competitive electric generation shall be in accordance with section 2806.

(12) The commission has the authority to order utility participation in retail access pilot programs as set forth in section 2806 and as further implemented or modified by the

commission, with direct access to begin on April 1, 1997. The commission shall conduct milestone reviews of the transition to retail electric generation competition to assure a technically workable and equitable transition period.

(13) Consistent with section 2808 (relating to competitive transition charge), the commission has the power and duty to approve a competitive transition charge for the recovery of transition or stranded costs it determines to be just and reasonable to recover from ratepayers.

(14) The transition to a competitive generation market shall be orderly, protect electric system reliability, be fair to ratepayers and provide the investors in Pennsylvania electric utilities with a fair opportunity to fully recover the amount of transition or stranded costs that the commission determines to be just and reasonable.

(15) At the time each utility files its restructuring plan with the commission, the utility shall submit an initial plan that sets forth how it shall meet its universal service and energy conservation obligations.

(16) The following shall apply:

(i) The commission shall issue regulations that permit the electric

distribution company to recover any change in its State tax liability under sections 2806(h), 2809(c) (relating to requirements for electric generation suppliers) and 2810 (relating to revenue-neutral reconciliation) or in its liability under 52 Pa. Code §§ 69.51 through 69.56 (relating to inclusion of State taxes and gross receipts taxes in base rates) to the extent that the resulting rate does not exceed the rate cap established in this section except as provided in this chapter.

(ii) With regard to any portion of the change in an electric distribution company's tax liability under section 2810 which would cause it to exceed the rate cap, the electric distribution company may file a single issue rate proceeding under section 1308(a) to recover that amount. The commission shall adjudicate, within 60 days, whether the resulting rates are just and reasonable.

(iii) With regard to any portion of the change in an electric distribution company's tax liability under sections 2806(h) and 2809(c) which would cause it to exceed the price cap, upon certification to the commission by

affidavit that the electric distribution company has not collected the taxes due pursuant to the tariff indemnification provisions required by section 2810(m) and that the electric distribution company and the Department of Revenue have not collected the taxes due pursuant to the other means set forth in sections 2806(g)(3)(i) and (ii) and 2809(c) to recover the taxes due and any interest thereon, the electric distribution utility shall be permitted to recover that amount in the State Tax Adjustment Surcharge.

* * *

§ 2805. Regionalism and reciprocity

(a) Other states. — The commission shall take all necessary and appropriate steps to encourage interstate power pools to enhance competition and to complement industry restructuring on a regional basis. The Commonwealth, the commission and Pennsylvania electric utilities shall work with the Federal Government, other states in the region and interstate power pools to accomplish the goals of restructuring and to establish independent system operators or their functional equivalents to operate the transmission system and interstate power pools. The commission, Pennsylvania electric utilities and all electricity suppliers shall work with the Federal Government, other

states in the region, the North American Electric Reliability Council and its regional coordinating councils or their successors, interstate power pools, and with the independent system operator or its functional equivalent to ensure the continued provision of adequate, safe and reliable electric service to the citizens and businesses of this Commonwealth.

(b) Electric cooperatives, municipalities and other electric suppliers. —

(1) In order to make the benefits of competition in the generation and sale of electricity as widely available as possible to retail customers and to provide open, fair and nondiscriminatory access to all electric generation suppliers:

(i) Consistent with 15 Pa.C.S. Ch. 74 (relating to generation choice for customers of electric cooperatives), no electric cooperative or municipality which distributes electricity to end-use customers may utilize the transmission or distribution system of an electric utility regulated by the commission for the purpose of supplying electricity to an end-use customer unless the electric cooperative or municipality provides open and nondiscriminatory access and allows other electric generation suppliers to utilize its facilities,

including any facilities it is entitled to provide to third parties pursuant to contract, to make sales to the end-use customers it serves. A borough may prohibit electric generation suppliers from serving end-use customers within its borough limits; however, such a borough shall be prohibited from providing generation service to end-use customers outside of its borough limits which it did not serve prior to the effective date of this chapter.

(ii) The commission shall require any electric cooperative seeking a certificate under 15 Pa.C.S. Ch. 74 to provide open and nondiscriminatory access to its transmission and distribution facilities as a condition to the granting of the certificate.

(iii) The reliability of the transmission service provided to electric cooperative corporations must be comparable to the reliability which the transmission supplier provides at the wholesale level.

(2) No electric utility regulated by the commission and no affiliate of such electric utility may use the distribution system of another electric utility regulated by the

commission or make sales to end-use customers in another electric utility's service territory unless the commission has approved a restructuring plan for the supplying electric utility which provides for direct access comparable to the direct access provided under the approved plan of the electric utility operating the distribution system in the location where the supplying electric utility seeks to sell electricity to an end-use customer. No electric utility regulated by the commission and no affiliate of such electric utility may use the distribution system of an electric cooperative corporation or make sales to end-use customers in the territory of an electric cooperative corporation unless the commission has approved a restructuring plan for the supplying electric utility.

* * *

§ 2806. Implementation, pilot programs and performance-based rates

(a) General rule. — The generation of electricity shall no longer be regulated as a public utility service or function except as otherwise provided for in this chapter at the conclusion of a transition and phase-in period beginning on the effective date of this chapter and ending, consistent with the commission's discretion under this section, January 1, 2001. As of January 1, 2001, consistent with the commission's discretion under this section, all customers of electric distribution

companies in this Commonwealth shall have the opportunity to purchase electricity from their choice of electric generation suppliers. The ultimate choice of the electric generation supplier is to rest with the consumer.

(b) Schedule. — Recognizing that approximately 5% of the peak load will have retail access through pilot programs, the following schedule for phased implementation of retail access shall be adhered to unless a determination is made by the commission under subsection (c):

(1) As of January 1, 1999, a maximum of 33% of the peak load of each customer class shall have the opportunity for direct access.

(2) As of January 1, 2000, a maximum of 66% of the peak load of each customer class shall have the opportunity for direct access.

(3) As of January 1, 2001, all customers of electric distribution companies in this Commonwealth shall have the opportunity for direct access.

(4) The commission shall establish regulations specifying that, within each customer class, the customers that are eligible for direct access prior to full direct access shall be determined on a first-come-first-served basis unless otherwise determined by the commission through regulation, in the context of restructuring plans, or in other appropriate

administrative proceedings, to prevent competitive disadvantages among similarly situated customers within a customer class.

(c) Additional time. —

(1) The commission may determine that an additional six-month transition period is necessary prior to the January 1, 1999, implementation date. A determination under this subsection must be made at least 45 days in advance of the scheduled date for implementation and must be based on one or more of the following considerations:

(i) Implementation would materially affect the reliability of the electric system.

(ii) Federal approvals necessary for the implementation of the provisions of this chapter have not been granted.

(iii) Communications and information systems necessary for the implementation of retail access have not been installed for reasons beyond the utility's control, as measured by appropriate industry standards.

(iv) Pennsylvania generators would be disadvantaged due to lack

of regional reciprocity with respect to direct access.

(v) The interests of Pennsylvania consumers and the competitive position of Pennsylvania business and industry would be materially affected.

(vi) Such other consideration as would materially affect the orderly implementation of the legislative purpose of this chapter under section 2802(12) through (21) (relating to declaration of policy).

(2) Consistent with the considerations listed in paragraph (1), the commission may determine that an additional six-month transition period is necessary. This determination must be made by the commission by May 15, 1999.

(d) Filing of restructuring plans. — All electric utilities in this Commonwealth shall submit to the commission, pursuant to a schedule to be determined by the commission in consultation with the electric utilities, beginning on April 1, 1997, but in no event later than September 30, 1997, a restructuring plan to implement direct access to a competitive market for the generation of electricity.

(e) Contents of restructuring plans. — A restructuring plan under subsection (d) must include,

consistent with the determinations of the commission, unbundled prices or rates for generation, jurisdictional transmission, distribution and other services; a proposed competitive transition charge; a proposed universal service and energy conservation cost-recovery mechanism; procedures for ensuring direct access to all licensed electric generation suppliers; a discussion of the impacts of the proposed plan on the utility's employees; and revised tariffs and the rate schedules implementing the above.

(f) Commission review. — The commission shall review the restructuring plan filed by each electric utility and shall, after open evidentiary hearings with proper notice and opportunity for all parties to cross-examine witnesses, issue an order accepting, modifying or rejecting such plan at the earliest date possible, but no later than nine months from the filing of such restructuring plan. If the commission rejects a restructuring plan, it shall state the specific reasons for rejection and direct the electric utility to file an alternative plan addressing these objections within 30 days of the entry date of the commission order rejecting the plan. The commission shall review the alternative plan, solicit comments from interested parties and issue a final order within 45 days of the filing of the revised plan.

(g) Retail access pilot programs. — As of the effective date of this chapter, the commission has authority to order electric utilities to submit proposals for retail access pilot programs to being April 1, 1997. The commission shall provide guidelines for retail access pilot programs by order.

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(1) In order to determine whether all customers classes can benefit from competitive markets, utilities shall tailor proposed retail access pilot programs to accommodate the specific geographic, demographic and socioeconomic characteristics of their customer base. Retail access pilot programs must include an equal opportunity for the broadest practical direct access by all customer classes to electric generation suppliers.

(2) The minimum period of time for a retail access pilot program shall be one year and shall include an evaluation process as directed by the commission.

(3) In order to ensure the safety and reliability of the generation of electricity in this Commonwealth, participation in the retail access pilot programs shall be limited to electricity suppliers subject to commission licensure or certification.

(i) Each participating electricity supplier shall do all of the following:

(A) Certify to the commission that it will pay and in subsequent years has paid the full amount of taxes imposed by Articles II and XI of the act of March 4, 1971

(P.L. 6, No. 2),[1] known as the Tax Reform Code of 1971, and any tax imposed by this chapter.

(B) Provide the commission with the address of the participant's principal office in this Commonwealth or the address of the participant's registered agent in this Commonwealth, the latter being the address at which the participant may be served process.

(C) Agree that it shall be subject to all taxes imposed by the Tax Reform Code of 1971 and any tax imposed by this chapter.

(ii) Failure of an electricity supplier to pay a tax referred to in subparagraph (i) or to otherwise comply with the provisions of this paragraph shall be cause for the commission to revoke the license of the electricity supplier.

(iii) If an electricity supplier, other than an electric distribution company,

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1. 72 P.S. § 7201 et seq. and 72 P.S. § 8101 et seq.

does not pay the tax imposed upon gross receipts under section 1101 of the Tax Reform Code of 1971 of this chapter, the electric distribution company to whose retail customer the electricity supplier provided generation service shall remit the unpaid tax, as a tax on the use of electricity in this Commonwealth, to the Department of Revenue and may collect or seek reimbursement of the tax so paid from the electricity provider or any other appropriate party that used the electricity in this Commonwealth. The department shall collect and enforce the use tax herein provided under section 1102 of the Tax Reform Code of 1971. Failure of the electric distribution company to pay the amount within 30 days after notice provided by the department shall cause interest to be imposed on the electric distribution company in accordance with Article XI of the Tax Reform Code of 1971. Interest shall be calculated from the 31st day after the department gives the notice required in this subparagraph. An electric distribution company or other appropriate person may challenge the imposition of the tax and interest by filing a petition with the department not later than 30 days after the date on which the tax became due.

(4) The percentage of utility load committed to a retail access pilot program must be approximately 5% of utility's peak load for each customer class. Waivers of this condition may be considered by the commission for economic development purposes or special circumstances.

(h) Flexible pricing. — In addition to the implicit authority of the commission under section 501 (relating to general powers), the commission has the authority to approve flexible pricing and flexible rates, including negotiated, contract-based tariffs designed to meet the specific needs of a utility customer and to address competitive alternatives.

(i) Performance-based rates and alternative regulation. — The commission has authority to use performance-based rates as an alternative to existing rate base/rate of return ratemaking, subject to the restrictions pertaining to rate caps in section 2804(4) (relating to standards for restructuring of electric industry).

* * *

§ 2807. Duties of electric distribution companies

(a) General rule. — Each electric distribution company shall maintain the integrity of the distribution system at least in conformity with the National Electric Safety Code and such other standards practiced by the industry in a manner sufficient to provide safe and

reliable service to all customers connected to the system consistent with this title and the commission's regulations. In performing such duties, the electric distribution company shall implement procedures to require all electric generation suppliers to deliver energy to the electric distribution company at locations and in amounts which are adequate to meet the energy supplier's obligations to its customers. Subject to commission approval, the electric distribution company may require that the customer install, at the customer's expense, enhanced metering capability sufficient to match the energy delivered by the electric generation suppliers with consumption by the customer.

(b) Procedures for review by the commission. — There shall be a rebuttable presumption that the electric distribution company has the ability to receive energy at all points on its system sufficient to meet the needs of all electric generation suppliers' customers on its system. The electric distribution company shall not have an obligation to install nonstandard facilities, either as to type or location, for the purpose of receiving energy from the energy supplier unless the energy supplier or its customer pays the full cost of these facilities. Nothing in this chapter shall prevent the electric distribution company from upgrading its system to meet changing customer requirements consistent with the requirements of section 1501 (relating to character of service and facilities), and the commission may establish incentive programs to encourage such system upgrades. Disputes concerning facilities shall be subject to the jurisdiction of the commission and may be initiated by the filing of a complaint under section 701 (relating to complaints) by the electric generation supplier or the customer.

(c) Customer billing. — Subject to the right of an end-use customer to choose to receive separate bills from its electric generation supplier, the electric distribution company may be responsible for billing customers for all electric services, consistent with the regulations of the commission, regardless of the identity of the provider of those services.

(1) Customer bills shall contain unbundled charges sufficient to enable the customer to determine the basis for those charges.

(2) If services are provided by an entity other than the electric distribution company, the entity that provides those services shall furnish to the electric distribution company billing data sufficient to enable the electric distribution company to bill customers.

(3) The electric distribution company shall not be required to forward payment to entities providing services to customers, and on whose behalf the electric distribution company is billing those customers, before the electric distribution company has received payment for those services from customers.

(d) Consumer protections and customer service. — The electric distribution company shall continue to provide customer service functions consistent with the regulations of the commission, including meter reading, complaint resolution and collections. Customer services shall, at a minimum, be maintained at the same level of quality under retail competition.

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(1) The commission shall establish regulations to ensure that an electric distribution company does not change a customer's electricity supplier without direct oral confirmation from the customer of record or written evidence of the customer's consent to a change of supplier.

(2) The commission shall establish regulations to require each electric distribution company, electricity supplier, marketer, aggregator and broker to provide adequate and accurate customer information to enable customers to make informed choices regarding the purchase of all electricity services offered by that provider. Information shall be provided to consumers in an understandable format that enables consumers to compare prices and services on a uniform basis.

(3) Prior to the implementation of any restructuring plan under section 2806 (relating to implementation, pilot programs and performance-based rates), each electric distribution company, in conjunction with the commission, shall implement a consumer education program informing customers of the changes in the electric utility industry. The program shall provide consumers with information necessary to help them make appropriate choices as to their electric service. The education program shall be subject to approval by the commission.

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(e) Obligation to serve. — An electric distribution company's obligation to provide electric service following implementation of restructuring and the choice of alternate generation by a customer is revised as follows:

(1) While an electric distribution company collects either a competitive transition charge or an intangible transition charge or until 100% of its customers have choice, whichever is longer, the electric distribution company shall continue to have the full obligation to serve, including the connection of customers, the delivery of electric energy and the production or acquisition of electric energy for customers.

(2) At the end of the transition period, the commission shall promulgate regulations to define the electric distribution company's obligation to connect and deliver and acquire electricity under paragraph (3) that will exist at the end of the phase-in period.

(3) If a customer contracts for electric energy and it is not delivered or if a customer does not choose an alternative electric generation supplier, the electric distribution company or commission-approved alternative supplier shall acquire electric energy at prevailing market prices to serve that customer and shall recover fully all reasonable costs.

(4) If a customer that chooses an alternative supplier and subsequently desires to return to

the local distribution company for generation service, the local distribution company shall treat that customer exactly as it would any new applicant for energy service.

* * *

§ 2808. Competitive transition charge

(a) General rule. — To provide each electric utility with an opportunity to recover its transition or stranded costs following the commission's determination under subsection (c), every customer accessing the transmission or distribution network shall pay a competitive transition charge to the electric distribution company in whose certificated territory that customer is located. The costs to be recovered shall be allocated to customer classes in a manner that does not shift interclass or intraclass costs and maintains consistency with the allocation methodology for utility production plant accepted by the commission in the electric utility's most recent base rate proceeding. If a customer installs on-site generation which operates in parallel with other generation on the public utility's system and which significantly reduces the customer's purchases of electricity through the transmission and distribution network, the customer's fully allocated share of transition or stranded costs shall be recovered from the customer through a competitive transition charge. The recovery of transition or stranded costs associated with existing generating facilities for which recovery has been approved, except when the generation facility is uneconomic on a production cost basis because of the transition to a competitive market.

(b) Period for collecting competitive transition charge. — The competitive transition charge shall be included on bills to customers for a period not to exceed nine years form the effective date of this chapter unless an alternative payment methodology is mutually agreed upon by the customer and the utility or unless the commission in its discretion and for good cause shown orders an alternative payment period. In establishing the length of the period for collection of the competitive transition charge, the commission shall consider the effect on the ability of the Commonwealth to compete in attracting industry and jobs, on the financial health of electric utilities and other relevant factors.

(c) Determination of competitive transition charge. — In determining the level of transition ~~or~~ stranded costs that an electric utility may recover through the competitive transition charge, the commission shall apply the following principles:

(1) The commission shall allow recovery of regulatory assets and other deferred charges typically recoverable under current regulatory practice, the unfunded portion of the utility's projected nuclear generating plant decommissioning costs and cost obligations under contracts with nonutility generating projects that have received a commission order. Nothing in this chapter shall be construed as requiring an electric utility or a nonutility generating project to enter into an arrangement to buydown, buyout and terminate or otherwise restructure a contract or as authorizing the

commission to require a utility to pursue such an arrangement with a nonutility generating project.

(2) The commission shall allow recovery of an electric utility's prudently incurred costs related to cancellation, buyout, buydown or renegotiation of nonutility generating projects consistent with section 527 (relating to cogeneration rules and regulations).

(3) The commission shall determine the level of other generation-related transition or stranded costs that may be removed through the competitive transition charge.

(4) The commission shall consider the extent to which the electric utility has undertaken efforts to mitigate generation-related transition or stranded costs by appropriate means in a manner that is reasonable under all of the circumstances, including consideration of whether mitigation has been commensurate with the magnitude of the electric utility's generation-related transition or stranded costs. During the transition period, electric utilities shall have the duty to mitigate generation-related transition or stranded costs to the extent practicable. Efforts may include the following:

(i) Acceleration of depreciation and amortization of existing rate base generation assets.

(ii) Minimization of new capital spending for existing rate base generation assets.

(iii) Reallocation of depreciation reserves to existing rate base generation assets.

(iv) Reduction of book assets by application of new proceeds of any sale of idle or underutilized existing rate base generation assets.

(v) Maximization of market revenues from existing rate base generation assets.

(vi) Issuance of securitized debt pursuant to the provisions of section 2812 (relating to approval of transition bonds).

(5) Of equal importance to the mitigation efforts under paragraph (4), the commission shall consider efforts undertaken over time, prior to the enactment of this chapter, to reduce or moderate customer rate levels while maintaining safe and efficient operations.

(d) Commission review. — As a component of its restructuring plan, each electric utility shall file with the commission a recovery plan, including a proposed competitive transition charge and supporting

documentation. In evaluating a recovery plan and any proposed competitive transition charge, the commission shall schedule open evidentiary hearings with proper notice and opportunity for all parties to cross-examine witnesses as necessary.

(e) Use of transition bonds. — After the effective date of this chapter, a utility may apply to the commission for a qualified rate order under section 2812 for some or all of its transition or stranded costs.

(1) In evaluating a utility application under this subsection, the commission shall schedule hearings, as necessary.

(2) If the commission issues a qualified rate order under section 2812 and if the transition bonds approved by that order are successfully issued, then:

(i) The utility shall impose and collect through its customer bills the intangible transition charges approved by that qualified rate order; and

(ii) simultaneously, either the utility's rates for electric service or the utility's competitive transition charges shall be reduced by an amount equal to the revenue requirement of the transition or stranded costs for which transition bonds have been successfully issued.

(f) Annual revenue. — Consistent with section 1307(e) (relating to sliding scale of rates; adjustments), the commission shall establish procedures for the annual review of the competitive transition charge. The review shall reconcile the annual revenues received from the charge with the annual amortization of transition or stranded costs approved by the commission under this section. The commission shall adjust the competitive transition charge based upon underrecovery or overrecovery of the annual amortization amount.

* * *

§ 2809. Requirements for electric generation suppliers

(a) License requirement. — No person or corporation, including municipal corporations which choose to provide service outside their municipal limits except to the extent provided prior to the effective date of this chapter, brokers and marketers, aggregators and other entities, shall engage in the business of an electric generation supplier in this Commonwealth unless the person or corporation holds a license issued by the commission. Consistent with 15 Pa.C.S. Ch. 74 (relating to generation choice for customers of electric cooperatives), electric cooperative corporations must possess a certificate for service to supply generation services beyond their territorial limits.

(b) License application and issuance. — An application for an electric generation supplier license must be made to the commission in writing, be verified by oath or affirmation and be in such form and contain

such information as the commission may by its regulations require. A license shall be issued to any qualified applicant, authorizing the whole or any part of the service covered by the application, if it is found that the applicant is fit, willing and able to perform properly the service proposed and to conform to the provisions of this title and the lawful orders and regulations of the commission under this title, including the commission's regulations regarding standards and billing practices, and that the proposed service, to the extend authorized by the license, will be consistent with the public interest and the policy declared in this chapter; otherwise, such application shall be denied.

(c) Financial responsibility. —

(1) In order to ensure the safety and reliability of the generation of electricity in this Commonwealth, no energy supplier license shall be issued or remain in force unless the holder complies with all of the following:

(i) Furnishes a bond or other security approved by the commission in form and amount to ensure the financial responsibility of the electric generation supplier and the supply of electricity at retail in accordance with contracts, agreements or arrangements.

(ii) Certifies to the commission that it will pay and in subsequent years

has paid the full amount of taxes imposed by Articles II and XI of the act of March 4, 1971 (P.L. 6, No. 2),[1] known as the Tax Reform Code of 1971, and any tax imposed by this chapter.

(iii) Provides the commission with the address of the participant's principal office in this Commonwealth or the address of the participant's registered agent in this Commonwealth, the latter being the address at which the participant may be served process.

(iv) Agrees that it shall be subject to all taxes imposed by the Tax Reform Code of 1971 and any tax imposed by this chapter.

Failure of an electricity supplier to pay a tax referred to in this paragraph or to otherwise comply with the provisions of this paragraph shall be cause for the commission to revoke the license of the electricity supplier.

(2) If an electricity supplier other than an electric distribution company does not pay the tax imposed upon gross receipts under section 1101 of the Tax Reform Code of 1971 or this chapter, the electric distribution company to whose retail customer the electricity supplier

1. 72 P.S. § 7201 et seq. and 72 P.S. § 8101 et seq.

provided generation service shall remit the unpaid tax, as a tax on the use of electricity in this Commonwealth, to the Department of Revenue and may collect or seek reimbursement of the tax so paid from the electricity provider or any other appropriate party that used the electricity in this Commonwealth. The department shall collect and enforce the use tax herein provided under section 1102 of Tax Reform Code of 1971. Failure of the electric distribution company to pay the amount within 30 days after notice provided by the department shall cause interest to be imposed on the electric distribution company in accordance with Article XI of the Tax Reform Code of 1971. Interest shall be calculated from the 31st day after the department gives the notice required in this paragraph. An electric distribution company or other appropriate person may challenge the imposition of the tax and interest by filing a petition with the department not later than 30 days after the date on which the tax became due.

(d) Transferability of licenses. — No license issued under this chapter may be transferred without prior commission approval.

(e) Form of regulation of electric generation suppliers. — The commission may forbear from applying requirements of this part which it determines are unnecessary due to competition among electric

generation suppliers. In regulating the service of electric generation suppliers, the commission shall impose requirements necessary to ensure that the present quality of service provided by electric utilities does not deteriorate, including assuring that adequate reserve margins of electric supply are maintained and assuring that 52 Pa. Code Ch. 56 (relating to standards and billing practices for residential utility services) are maintained.

(f) Availability of the services of brokers and marketers or aggregators. — Prior to approving the licensure of any broker and marketer or aggregator, the commission shall set forth standards to ensure that all retail customer classes may choose to purchase electricity through a broker and marketer or aggregator. The commission shall also ensure that brokers, marketers and aggregators comply with 52 Pa. Code Ch. 56.

* * *

§ 2810. Revenue-neutral reconciliation

(a) General intent of revenue-neutral reconciliation. — It is the intention of the General Assembly that the restructuring of the electric industry be accomplished in a manner that allows Pennsylvania to enjoy the benefits of competition, promotes the competitiveness of Pennsylvania's electric utilities and maintains revenue neutrality to the Commonwealth. This section is not intended to cause a shift in proportional tax obligations among customer classes or individual electric distribution companies. It is the

intention of the General Assembly to establish this revenue replacement at a level necessary to recoup losses that may result from the restructuring of the electric industry and the transition thereto.

(b) Imposition. —

(1) For tax periods beginning on or after January 1, 1999, a tax at the rate provided in subsection (c) is imposed upon the gross receipts of electric distribution companies and electric generation suppliers.

(2) A tax at the rate provided in subsection (c) is imposed upon the gross receipts of any municipality owned or operated public utility or of any public utility service furnished by any municipality. Gross receipts shall be exempt from the tax to the extent that gross receipts are derived from sales of electric energy inside the limits of the municipality owning or operating the public utility or furnishing the public utility service.

(3) A tax at the rate provided in subsection (c) is imposed upon the gross receipts derived from any electric cooperative owned or operated public utility or from any public utility service furnished by any electric cooperative. Gross receipts shall be exempt from the tax to the extent that gross receipts are derived from sales for resale or sales of electric energy within the limits of its service territory as set forth in

15 Pa.C.S. § 7406 (relating to competition by electric cooperatives).

(c) Rate. —

(1) By December 1, 1998, and each October 1 thereafter until and including October 1, 2002, the Secretary of Revenue shall publish the rate of tax as provided in paragraph (2) in the form of a notice in the Pennsylvania Bulletin and the rate shall apply to the tax imposed by subsection (b) for the period beginning the next January 1. The tax rate published on October 1, 2002, shall continue in force without further adjustment. If the commission determines under section 2806(c) (relating to implementation, pilot programs and performance-based rates) to extend the transition period by more than six months, the requirement for an annual adjustment of the tax rate shall be extended by one additional year. The secretary shall also certify the rate calculated to the majority and minority chairs of the Appropriations Committee of the Senate and the Appropriations Committee of the House of Representatives and detail the calculations of the rate.

(2) The secretary shall calculate the rate for the periods beginning on and after January 1, 1999, in the manner set forth in this paragraph.

(i) Multiply the 1995-1996 fiscal tax revenue base by a fraction, the

numerator of which is the total kilowatt hours of electricity distributed for ultimate consumption in Pennsylvania in the preceding calendar year as certified by the commission and the denominator of which is the total kilowatt hours of electricity distributed for ultimate consumption in Pennsylvania in the calendar year 1995 as certified by the commission.

(ii) From the product derived under subparagraph (i), subtract the total cash payments made to the department during the Commonwealth's preceding fiscal year on account of affected taxes actually paid by each electric distribution company and electric generation supplier and by any other entity, including a successor, whose affected taxes are contained in the 1995-1996 fiscal tax revenue base.

(iii) Divide the difference derived under subparagraph (ii) by the total gross receipts in the preceding calendar year as certified by the commission to determine the tax rate. The tax rate under this subparagraph shall be a decimal rounded to three places.

(3) On August 1, 2000, August 1, 2001, and August 1, 2002, the department shall deliver a report to the General Assembly and the Governor that shall describe the dynamic economic effect upon the affected taxes due to electric utility restructuring. It is the purpose of this report to provide the General Assembly and the Governor with information to determine whether it is appropriate to consider modifying the calculation described in paragraph (2) to reflect additional tax revenues, if any, resulting from the dynamic economic effects upon the affected taxes.

(4) If the effective rate for any affected tax is different from the effective rate for such affected tax in the 1995-1996 fiscal tax revenue base, an adjustment shall be made to the computation of the rate of tax under paragraph (2) by multiplying that portion of the 1995-1996 fiscal tax revenue base attributable to the affected tax by a fraction, the numerator of which is the effective rate of the affected tax for the preceding fiscal year and the denominator of which is the effective rate of tax of the affective tax in the base fiscal year.

(5) For negative rates:

(i) If the rate of tax calculated for a tax year prior to the tax year beginning January 1, 2004, or January 1, 2005, in the event of an extension

by more than six months by the commission as provided in section 2806(c) is negative, a credit equal to the negative tax rate for such tax year multiplied by the taxable gross receipts for that tax year shall be allowed against the taxpayer's liability for any tax for that tax year imposed under Article XI of the act of March 4, 1971 (P.L. 6, No. 2),[1] known as the Tax Reform Code of 1971.

(ii) If the rate of tax calculated as the final adjustment is negative for the tax period beginning January 1, 2003, or January 1, 2004, in the event of an extension by more than six months by the commission as provided in section 2806(c), the rate of tax imposed by section 1101(b) of the Tax Reform Code of 1971 for the tax years beginning January 1, 2004, and thereafter, or January 1, 2005, and thereafter, in the event of an extension by more than six months, shall be adjusted and set as follows: the tax rate expressed as a decimal rounded to three positions shall be subtracted from .044 or the current rate imposed under section 1101(b) of the Tax Reform Code of 1971 to determine the

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adjusted tax rate. The adjusted tax rate shall be published in the Pennsylvania Bulletin.

(6) Information to be provided to the department or the commission shall be as follows:

(i) To ensure the identification of cash payments for purposes of subsection (d), the commission shall require any licensee, electric distribution company, electric generation supplier or other person affected to disclose on its license application, renewal or transfer its State tax account or similar number relative to any of the taxes specified.

(ii) The commission shall report and certify to the secretary of the department by August 1, 1998, and each August 1 thereafter the total amount of electricity distributed for ultimate consumption in this Commonwealth during the previous two calendar years and the total gross receipts for the past year.

(iii) As a condition of licensure, the commission shall require each electric distribution company and electric generation supplier to report

their annual gross receipts in this Commonwealth.

(iv) For purposes of enforcing sections 2806 and 2809 (relating to requirements for electric generation suppliers) as they relate to the payment of State taxes, an applicant for the grant, renewal or transfer of a license issued under this title shall, by filing an application with the commission, waive confidentiality with respect to State tax information regarding the applicant in the possession of the department, regardless of the source of the information, and shall consent to the department providing that information to the commission.

(7) Beginning June 15, 1999, and each year thereafter, an amount equal to 0.18% of total utilities gross receipts shall be deposited into the Public Transportation Assistance Fund as provided in Article XXIII of the Tax Reform Code of 1971.

(d) Payment of tax and reports. — The tax imposed under subsection (b) shall be paid within the time prescribed by law. For the purpose of ascertaining the amount of the tax, the treasurer or other appropriate officer of the taxpayer shall transmit to the department by March 15 an annual report, and under oath or

affirmation, of the amount of gross receipts received by the taxpayer during the prior calendar year. The treasurer or other appropriate officer of the taxpayer liable to report or pay taxes imposed under subsection (b), except municipalities and cooperatives, shall transmit to the department by March 15 a tentative report for the prior calendar year. The tentative report shall set forth all of the following:

(i) The amount of gross receipts received in the period of 12 months next preceding and reported in the annual report.

(ii) The gross receipts received in the first three months of the current calendar year.

(iii) Other information as the department may require.

(e) Tax computation. — Upon the date its tentative report is required to be made, the taxpayer making a tentative report shall transmit the report to the department on account of the tax due for the current calendar year and compute and make payment of the tentative tax with the report under section 3003 of the Tax Reform Code of 1971.

(f) Time to file reports. — The time for filing annual reports may be extended, estimated settlements may be made by the department if reports are not filed, and the penalties for failing to file reports and pay the

taxes imposed under subsection (b) shall be as prescribed by the laws defining the powers and duties of the department. If the works of a taxpayer are operated by another taxpayer, the taxes imposed under subsection (b) shall be apportioned between the taxpayers in accordance with the terms of their respective leases or agreements. For the payment of the apportioned taxes, the Commonwealth shall first look to the taxpayer operating the works. Upon payment by that taxpayer, no other taxpayer shall be held liable for any tax imposed under subsection (b).

(g) Timely mailing treated as timely filing and payment. — Notwithstanding the provisions of any State tax law to the contrary, whenever payment of all or any portion of a State tax is required by law to be received by the department or other agency of the Commonwealth by a day certain, the taxpayer shall be deemed to have complied with that law if the letter transmitting payment of the tax which has been received by the department is postmarked by the United States Postal Service on or prior to the final day on which the payment is to be received.

(h) Procedure, enforcement and penalties. — Parts III, IV, VI and VII of Article IV and Article XXX of the Tax Reform Code of 1971 shall apply to this section insofar as they are consistent with this section and applicable to the tax imposed under subsection (b). Notwithstanding the provisions of section 493(d) of the Tax Reform Code of 1971, if the officers of any corporation subject to tax under this chapter neglect or refuse to make a report as required in this chapter or

knowingly make a false report, the department shall add to the tax determined to be due a penalty of 5% of the amount of tax due for each month or fraction of a month until the penalty has reached 25% and thereafter a penalty of 1% of the amount of tax due for each month or fraction of a month. Penalties added to the tax shall not bear interest.

(i) Electric light, waterpower and hydroelectric utilities. — The terms "electric light company," "waterpower company" and "hydroelectric company," as used in section 1101(b) of the Tax Reform Code of 1971, shall be deemed to include electric distribution companies and electric generation suppliers.

(j) Sales of electric energy. — Retail sales of electric generation, transmission, distribution or supply of electric energy, dispatching services, customer services, competitive transition charges and universal service and energy conservation charges and such other retail sales in this Commonwealth the receipts of which, if bundled, would have been deemed to be sales of electric energy prior to the effective date of this chapter shall be deemed sales of electric energy for purposes of section 1101 of the Tax Reform Code of 1971. The phrases "doing business in this Commonwealth" and "engaged in electric light and power business, waterpower business and hydroelectric business in this Commonwealth," as such terms are used in section 1101(b) of the tax Reform Code of 1971 and in this chapter, shall be construed to include the direct or indirect engaging in, transacting or conducting of activity in this Commonwealth for the purpose of establishing or maintaining a market for the sales of

electric energy and include obtaining a license or certification from the commission to supply electric energy. Retail sales of generation shall be deemed to occur at the meter of the retail consumer.

(k) Electric Cooperatives. — Section 1101(b) of the Tax Reform Code of 1971 shall apply to electric cooperatives and impose a tax upon the gross receipts derived from any electric cooperative owned or operated public utility or from any public utility service furnished by any electric cooperative. Gross receipts shall be exempt from the tax to the extent that the gross receipts are derived from sales for resale or sales of electric energy within the limits of its service territory as set forth in 15 Pa.C.S. § 7406.

(l) Provisions to be construed with utilities gross receipts tax. — Subsections (i), (j) and (k) shall be construed in conjunction with Article XI of the Tax Reform Code of 1971 and shall be effective for tax years beginning January 1, 1997, and thereafter.

(m) Indemnification. — The electric distribution utility company's tariff shall provide that, if an electric distribution company becomes liable under sections 2806(g) and 2809(c) for State taxes not paid by an electric generation supplier, that electric generation supplier shall indemnify the electric distribution company for the amount of the liability so imposed upon the electric distribution utility.

(n) Definitions. — As used in this section, the following words and phrases shall have the meanings given to them in this subsection:

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"Affected taxes." The taxes imposed under Articles II, IV, VI and XI and section 2301(f) of the act of March 4, 1971 (P.L. 6, No. 2), known as the Tax Reform Code of 1971.

"Base fiscal year." The year beginning on July 1, 1995, and ending on June 30, 1996.

"Department." The Department of Revenue of the Commonwealth.

"Effective rate." The tax rate applicable during the fiscal year or, if more than one rate is applicable, the average of the rates that were in effect for each month of the fiscal year.

"Fiscal year." A year beginning on July 1 and ending on the subsequent June 30.

"Gross receipts." The gross receipts from the retail sales of electric energy as defined in section 1101(b) of the Tax Reform Code of 1971.

"1995-1996 fiscal tax revenue base." The receipts from affected taxes from the fiscal year 1995-1006, such amount being $984,141,837.

"Portion of the 1995-1996 fiscal tax revenue base attributable to the affected tax." The following amounts for the tax indicated:

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Tax	Amount
Corporate net income tax	$181,628,433
Capital stock-franchise tax	$117,495,605
Sales and use tax	$187,401,632
Public utility realty tax	$ 43,883,573
Utilities gross receipts tax	$453,732,594

"Total utilities gross receipts." The total gross receipts for a calendar year for all electric distribution companies and electric generation suppliers which are derived from the sales of electric energy and required to be reported to the commission under subsection (c)(6)(iii).

* * *

§ 2811. Market power remediation

(a) Monitoring competitive conditions. — The commission shall monitor the market for the supply and distribution of electricity to retail customers and take steps as set forth in this section to prevent anticompetitive or discriminatory conduct and the unlawful exercise of market power.

(b) Initiation of investigations. — Upon complaint or upon its own motion for good cause shown, the commission shall conduct an investigation of the impact on the proper functioning of a fully competitive retail electricity market, including the effect of mergers, consolidations, acquisition or disposition of assets or securities of electricity suppliers, transmission

congestion and anticompetitive or discriminatory conduct affecting the retail distribution of electricity.

(c) Conduct of investigations. —

(1) The commission may require an electricity supplier to provide information, including documents and testimony, in accordance with the commission's regulations regarding the discovery of information from any electricity supplier.

(2) Confidential, proprietary or trade secret information provided under this subsection shall not be disclosed to any person not directly employed or retained by the commission to conduct the investigation without the consent of the party providing the information.

(3) Notwithstanding the prohibition on disclosure of information in paragraph (2), the commission shall disclose information obtained under this subsection to the Office of Consumer Advocate and the Office of Small Business Advocate under an appropriate confidentiality agreement. The commission may disclose the information to appropriate Federal or State law enforcement officials if it determines that the disclosure of the information is necessary to prevent or restrain a violation of Federal or State law and it provides the party that provided the information with reasonable notice and opportunity to prevent or limit disclosure.

(d) Referrals and intervention. — If, as a result of an investigation conducted under this section, the commission has reasons to believe that anticompetitive or discriminatory conduct, including the unlawful exercise of market power, is preventing the retail electricity customers in this Commonwealth from obtaining the benefits of a properly functioning and workable competitive retail electricity market, the commission, pursuant to its regulations, shall:

(1) Refer its findings to the Attorney General, the United States Department of Justice, the Securities and Exchange Commission or the Federal Energy Regulatory Commission.

(2) Subject to subsection (c)(3), disclose any information it has obtained in the course of its investigation to the agency or agencies to which it has made a referral under paragraph (1).

(3) Intervene, as provided and permitted by law or regulation, in any proceedings initiated as a result of a referral made under paragraph (1).

(e) Approval of proposed mergers, consolidations, acquisitions or dispositions. —

(1) In the exercise of authority the commission otherwise may have to approve the mergers or consolidations by electric utilities

or electricity suppliers, or the acquisition or disposition of assets or securities of other public utilities or electricity suppliers, the commission shall consider whether the proposed merger, consolidation, acquisition or disposition is likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power, which will prevent retail electricity customers in this Commonwealth from obtaining the benefits of a properly functioning and workable competitive retail electricity market.

(2) Upon request for approval, the commission shall provide notice and an opportunity for open, public evidentiary hearings. If the commission finds, after hearing, that a proposed merger, consolidation, acquisition or disposition is likely to result in anticompetitive or discriminatory conduct, including the unlawful exercise of market power, which will prevent retail electricity customers in this Commonwealth from obtaining the benefits of a properly functioning and workable competitive retail electricity market, the commission shall not approve such proposed merger, consolidation, acquisition or disposition, except upon such terms and conditions as it finds necessary to preserve the benefits of a properly functioning and workable competitive retail electricity market.

(f) Preservation of rights. — Nothing in this section shall restrict the right of any party to pursue any other remedy available to it under this part.

* * *

§ 2812. Approval of transition bonds

(a) Qualified rate orders. — Notwithstanding any other provision of law, the commission is authorized to issue qualified rate orders in accordance with the provisions of this subsection to facilitate the recovery or financing of qualified transition expenses of an electric utility or assignee.

(1) A qualified rate order may be adopted by the commission only upon the application of an electric utility and shall become effective in accordance with its terms. After the issuance of a qualified rate order, the electric utility retains sole discretion regarding whether to assign, sell or otherwise transfer intangible transition property or to cause the transition bonds to be issued, including the right to defer or postpone such assignment, sale, transfer or issuance.

(2) After the effective date of this chapter, an electric utility may file an application for a qualified rate order pursuant to the following procedures:

(i) Each application for a qualified rate order shall contain a complete

accounting of the utility's transition or stranded costs, detailed information regarding the utility's proposal for sale of intangible transition property or the issuance of transition bonds and information regarding the electric utility's planned use of the proceeds of the sale or issuance. After the utility has filed its restructuring plan under section 2806 (relating to implementation, pilot programs and performance-based rates), the utility may incorporate by reference the information in the restructuring plan in providing the information.

(ii) An electric utility may file an application for a qualified rate order concurrently with, prior to, during or following the filing of its restructuring plan under section 2806. If an electric utility requests expedited review under subsection (b)(1)(i) or (ii), it shall designate in its application the portion of its total claimed transition or stranded costs for which it requests such expedited review.

(iii) After notice and an opportunity to be heard, the commission may issue a final qualified rate order for all or a portion of the amount of transition or stranded

costs that it finds would be just and reasonable for the utility to recover from ratepayers under sections 2805 (relating to standards for restructuring of electric industry) and 2808 (relating to competitive transition charge). The commission shall issue a final qualified rate order only for the amounts for which it finds such issuance to be in the public interest. The commission shall complete its review of the application and issue its final determination by the later of nine months from the filing, unless the electric utility requests expedited treatment under subsection (b), or 15 days following the filing of the electric utility's restructuring plan under section 2806.

(b) Expedited review procedures. —

(1) The commission shall provide for expedited review of applications for qualified rate orders upon request of the electric utility pursuant to the following procedures:

(i) If the utility elects to file an application prior to the filing of its restructuring plan and requests expedited review, the commission, after notice and an opportunity to be heard, may issue a final qualified rate

order approving the issuance of transition bonds for a portion of the utility's transition or stranded costs that the commission finds would be just and reasonable to recover from ratepayers under sections 2804 and 2808. The commission shall consider only the portion of the transition or stranded costs for which the utility requests approval to issue transition bonds. Consideration of all remaining amounts and amounts not resolved by the commission shall be deferred for consideration in the electric utility's restructuring plan proceeding under section 2806. The commission shall complete its review of the application and issue its final determination within 120 days after the request for expedited review but in no event earlier than 15 days after the utility has filed its restructuring plan under section 2806.

(ii) If the electric utility files an application for a qualified rate order concurrently with its restructuring plan or during the course of the restructuring plan proceeding, the electric utility may request, and the commission may allow, an accelerated determination of the application. After notice and an opportunity to be heard,

the commission may issue a final qualified rate order approving the issuance of transition bonds for a portion of the utility's stranded or transition costs that the commission finds would be just and reasonable to recover from ratepayers under sections 2804 and 2808. The commission shall consider only the portion of the utility's transition or stranded costs for which the utility seeks expedited review. Consideration of all remaining amounts and amounts not resolved by the commission shall be deferred for consideration in a final order regarding the utility's restructuring plan under section 2806. The commission shall complete its review of the application and issue its final determination within 120 days after the request for expedited review.

(iii) If the electric utility files an application for a qualified rate order after the commission enters a final order regarding the utility's restructuring plan, and requests expedited treatment, the commission shall complete its review and issue its final determination within 120 days of the request for expedited review.

(2) The qualified rate order shall require that the proceeds from the assignment, sale or

transfer or other financing of intangible transition property shall be used principally to reduce the electric utility's transition or stranded costs and to reduce the related capitalization, pursuant to a plan submitted by the electric utility in its application for a qualified rate order and approved by the commission.

(3) Notwithstanding any other provision of law, the commission has the power to specify that all or a portion of a qualified rate order shall be irrevocable. To the extent so specified, neither the order nor the intangible transition charges authorized to be imposed and collected under the order shall be subject to reduction, postponement, impairment or termination by any subsequent action of the commission. Nothing in this paragraph is intended to supersede the right of any party to judicial review of the qualified rate order.

(4) The commission shall provide in any qualified rate order for a procedure for the expeditious approval by the commission of periodic adjustments to the intangible transition charges that are the subject of the pertinent qualified rate order. Such adjustments shall ensure the recovery of revenues sufficient to provide for the payment of principal, interest, acquisition or redemption premium and for other fees, costs and charges in respect of transition bonds approved by the commission

as part of or in conjunction with a qualified rate order. The commission shall determine whether the adjustments are required on each anniversary of the issuance of the qualified rate order and at the additional intervals as may be provided for in the qualified rate order. The adjustments, if required, shall be approved within 90 days of each anniversary of the issuance of the qualified rate order or of each additional interval provided for in the qualified rate order.

(5) Notwithstanding any other provision of law, on such conditions as the commission may approve, all or portions of the interest of an electric utility in intangible transition property may be assigned, sold or transferred to an assignee and may be pledged or assigned as security by an electric utility or assignee to or for the benefit of a financing party. To the extent that an interest is assigned, sold or transferred or is pledged or assigned as security, the commission shall authorize the electric utility to contract with the assignee or financing party that the electric utility will continue to operate its system to provide service to its customers, will impose and collect the applicable intangible transition charges for the benefit and account of the assignee or financing party and will account for and remit the applicable intangible transition charge to or for the account of the assignee or financing party. If the qualified rate order so provides, the obligations of the electric utility:

(i) shall be binding upon the electric utility, its successors and assigns; and

(ii) shall be required by the commission to be undertaken and performed by the electric utility and any other entity which provides electric service to a person that was a customer of an electric utility located within the certificated territory of the electric utility on the effective date of this chapter or that became a customer of electric services within such territory after the effective date of this chapter and is still located within such territory, as a condition to the provision of service to such customer by such electric utility or other entity, unless the customer has paid a termination charge in the manner and on the basis specified in the qualified rate order.

(6) The irrevocable status of any portion of a qualified rate order under paragraph (3) shall lapse and terminate to the extent that an assignment, sale or transfer of the intangible transition property resulting from the rate order or the issuance of the related transition bonds is not effected within the period specified in the qualified rate order.

(7) The effect of any subsequent refinancing of transition bonds upon the rates authorized in a qualified rate order shall be provided in such order.

(8) In its qualified rate order, the commission shall afford flexibility in establishing the terms and conditions of the transition bonds, including repayment schedules, interest rates and other financing costs. The electric utility shall file the final terms of issuance with the commission.

(c) Intangible transition property. —

(1) Any right that an electric utility has in the intangible property prior to its sale or transfer or any other right created under this section or created in the qualified rate order and assignable under this section or assignable pursuant to a qualified rate order shall be only a contract right.

(2) The Commonwealth pledges to and agrees with the holders of any transition bonds issued under this section and with any assignee or financing party who may enter into contracts with an electric utility under this section that the Commonwealth will not limit or alter or in any way impair or reduce the value of intangible transition property or intangible transition charges approved by a qualified rate order until the transition bonds and interest on

the transition bonds are fully paid and discharged or the contracts are fully performed on the part of the electric utility. Subject to other requirements of law, nothing in this paragraph shall preclude limitation or alteration if adequate compensation is made by law for the full protection of the intangible transition charges collected pursuant to a qualified rate order and of the holder of this transition bond and any assignee or financing party entering into contract with the electric utility.

(d) Security interests in intangible transition property. —

(1) Neither intangible transition property nor any right, title or interest of a utility or assignee described in paragraph (1) of the definition of "intangible transition property" in subsection (g), whether before or after the issuance of the qualified rate order, shall constitute "an account" or "general intangibles" under 13 Pa.C.S. § 9106 (relating to definitions: "account"; "general intangibles"); nor shall any such right, title or interest pertaining to a qualified rate order, including the associated intangible transition property and any revenues, collections, claims, payments, money or proceeds of or arising from intangible transition charges pursuant to such order, be deemed proceeds of any right or interest other than in the order and the intangible transition property arising from the order.

(2) The granting, perfection and enforcement of security interests in intangible transition property to secure transition bonds is governed by this section rather than by Title 13 (relating to commercial code).

(3) A valid and enforceable security interest in intangible property shall attach and be perfected only by means of a separate filing with the commission, under regulations the commission prescribes. For this purpose:

(i) If the transition bonds are issued to finance any qualified transition expenses, as specified in the applicable qualified rate order, the lien of the bonds shall attach automatically to the intangible transition property relating to the expenses from the time of issuance of the bonds.

(ii) The lien under subparagraph (i) shall be deemed a valid and enforceable security interest in the intangible transition property securing the qualified transition bonds and shall be continuously perfected if, before the date of issuance specified in subparagraph (i) or within no more than ten days after the date, a filing has been made by or on behalf of the financing party to protect that security interest in accordance with the

procedures prescribed by the commission under this subsection. Any filing in respect to such transition bonds shall take precedence over any other filing.

(iii) The lien under subparagraph (i) is enforceable against the assignee and all third parties, including judicial lien creditors, subject only to the rights of any third parties holding security interests in the intangible transition property previously perfected in the manner described in this subsection if value has been given by the purchasers of transition bonds. A perfected lien in intangible transition property is a continuously perfected security interest in all revenues and proceeds arising with respect to the associated intangible transition property, whether or not revenues have accrued. Intangible transition property constitutes property for the purposes of contracts securing transition bonds, whether or not the related revenues have accrued. The lien created under this paragraph is perfected and ranks prior to any other lien, including any judicial lien, which subsequently attaches to the intangible transition property, to the intangible transition charges, and to

the qualified rate order and any rights created by the order or any proceeds of the order. The relative priority of a lien created under this paragraph is not defeated or adversely affected by changes to the qualified rate order or to the intangible transition charges payable by any customer.

(iv) The relative priority of a lien created under this paragraph is not defeated or adversely affected by the commingling of revenues arising with respect to intangible transition property with funds of the electric utility or other funds of the assignee.

(v) If an event of default occurs under approved transition bonds, the holders of transition bonds or their authorized representatives, as secured parties, may foreclose or otherwise enforce the lien in the intangible transition property securing the transition bonds, subject to the rights of any third parties holding prior security interests in the intangible transition property perfected in the manner provided in this subsection. Upon application by the holders or their representatives, without limiting their other remedies, the commission shall order the sequestration and

payment to the holders or their representatives of revenues arising with respect to the intangible transition property pledged to the holders. An order under this subparagraph shall remain in full force and effect notwithstanding any bankruptcy, reorganization or other insolvency proceedings with respect to the electric utility or assignee.

(4) The commission shall establish and maintain a separate system of records to reflect the date and time of receipt of all filings made under this subsection and may provide that transfers of intangible transition property to an assignee be filed in accordance with the same system.

(e) True sale. — A transfer of intangible transition property by an electric utility to an assignee which the parties have in the governing documentation expressly stated to be a sale or other absolute transfer, in a transaction approved in a qualified rate order, shall be treated as an absolute transfer of all of the transferor's right, title and interest, as in a true sale, and not as a pledge or other financing, of the intangible transition property, other than for Federal and State income and franchise tax purposes. Granting to holders of transition bonds a preferred right to the intangible transition property or the provision by the electric utility of any credit enhancement with respect to transition bonds shall not impair or negate the characterization of any transfer

as a true sale, other than for Federal and State income and franchise tax purposes. A transfer of intangible transition property shall be deemed perfected as against third persons, including any judicial lien creditors, when all of the following have taken place:

(1) The commission has issued the qualified rate order creating intangible transition property.

(2) A sale or transfer of the intangible transition property in writing has been executed and delivered to the assignee.

(f) Actions with respect to intangible transition charges. —

(1) Nothing in this chapter shall entitle any person to bring an action against a retail electric customer for nonpayment of intangible transition charges, other than the electric utility, its successor or any other entity which provides electric service to a person that was a customer of an electric utility located within the certificated territory of the electric utility on the effective date of this chapter or that became a customer of electric services within such territory after the effective date of this chapter and is still located within such territory.

(2) The commission has exclusive jurisdiction over any dispute arising out of the obligations to impose and collect intangible

transition charges of an electric utility, its successor or any other entity which provides electric service to a person that was a customer of an electric utility located within the certificated territory of the electric utility on the effective date of this chapter or that became a customer of electric services within such territory after the effective date of this chapter and is still located within such territory.

(g) Definitions. — As used in this section, the following words and phrases shall have the meanings given to them in this subsection:

"Assignee." An entity, including a corporation, public authority, trust or financing vehicle, to which an electric utility assigns, sells or transfers other than as security all or a portion of its interest in or right to intangible transition property. The term includes an entity, including a corporation, public authority, trust or financing vehicle to which a direct assignee of an electric utility may assign, sell or transfer other than as security its interest in or right to intangible transition property.

"Financing party." A holder of transition bonds, including trustees, collateral agents and other entities acting for the benefit of such a holder.

"Intangible transition charges." The amounts authorized to be imposed on all customer bills and collected, through a nonbypassable mechanism by the electric utility or its successor or by any other entity

which provides electric service to a person that was a customer of an electric utility located within the certificated territory of the electric utility on the effective date of this chapter or that, after this effective date of this chapter, became a customer of electric services within such territory and is still located within such territory, to recover qualified transition expenses pursuant to a qualified rate order. The amounts shall be allocated to customer classes in a manner that does not shift interclass or intraclass costs and maintains consistency with the allocation methodology for utility production plant accepted by the commission in the electric utility's most recent base rate proceeding.

"Intangible transition property."

(1) The property right created under this section representing the irrevocable right of the electric utility or an assignee to receive through intangible transition charges amounts sufficient to recover all of its qualified transition expenses. The term includes all right, title and interest of the electric utility or assignee in the qualified rate order and in all revenues, collections, claims, payments, money or proceeds of or arising from intangible transition charges pursuant to the order, to the extent that, in accordance with this chapter the order and the rates and other charges authorized under the order are declared to be irrevocable.

(2) Intangible transition property shall arise and exist only when, as and to the extent that

an electric utility or assignee has qualified transition expenses for which intangible transition charges are authorized in a qualified rate order that has become effective in accordance with subsection (a) and shall thereafter continuously exist to the extent provided in the order.

"Qualified rate order." An order of the commission adopted in accordance with this section, authorizing the imposition and collection of intangible transition charges.

"Qualified transition expenses." The transition or stranded costs of an electric utility approved by the commission for recovery under sections 2804 (relating to standards for restructuring of electric industry) and 2808 (relating to competitive transition charge), through the issuance of transition bonds; the costs of retiring existing debt or equity capital of the electric utility or its holding company parent, including accrued interest and acquisition or redemption premium, costs of defeasance, and other related fees, costs and charges relating to, through the issuance of transition bonds or the assignment, sale or other transfer of intangible transition property; and the costs incurred to issue, service or refinance the transition bonds, including accrued interest and acquisition or redemption premium, and other related fees, costs and charges, or to assign, sell or otherwise transfer intangible transition property.

"Transition bonds." Bonds, debentures, notes, certificates of participation or of beneficial interest or other evidences of indebtedness or ownership which:

(1) are issued by or on behalf of the electric utility or assignee pursuant to a qualified rate order;

(2) are secured by or payable from intangible transition property; and

(3) reach final maturity in no longer than ten years.

* * * *

APPENDIX F — EXCERPTS OF BRIEF OF INTERVENOR INDIANAPOLIS POWER & LIGHT COMPANY

COMMONWEALTH OF PENNSYLVANIA
BEFORE THE
PENNSYLVANIA PUBLIC UTILITY COMMISSION

DOCKET NO. R-00973877

PENNSYLVANIA PUBLIC UTILITY COMMISSION, ET AL.,

vs.

PECO ENERGY COMPANY.

BRIEF OF INTERVENOR
INDIANAPOLIS POWER & LIGHT COMPANY

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Dated: March 25, 1997

Appendix F

BRIEF OF INTERVENOR INDIANAPOLIS POWER & LIGHT COMPANY

Statement of the Case[1]

PECO Energy Company has requested relief under House Bill No. 1509, amending Title 66 by adding Chapter 28 concerning "Restructuring of Electric Utility Industry" (hereinafter the "Competition Act," the "Act," or "the Statute.") PECO's request is for authority to issue certain securities for the purpose of recovering approximately $3.6 billion of so-called "transition costs" or "stranded costs" under the Act, a process known as "securitization." Intervenor Indianapolis Power & Light Company ("IPL") opposes the relief requested by PECO on numerous grounds set forth herein.

ISSUE I. The Competition Act Violates the Commerce Clause of the U.S. Constitution, as Does the Effect of PECO's Request Under the Competition Act.

Summary of Argument

The Commerce Clause, which affirmatively grants Congress the power "to regulate Commerce . . . among the several States,"[2] also restricts state authority to regulate interstate commerce.[3] This negative sweep of the Commerce

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1. All reference to the record of proceedings hereinafter shall be as follows: [R – (*page*)] if from the Transcript; [(*Name*) Direct/Rebuttal (*page*)] if from the pre-filed testimony as admitted; or [Exhibit (*page*)] if from an Exhibit admitted into the record. References to portions of the Act will be noted as follows: [Sec. __].

2. U.S. CONST. Art. 1 §3, cl. 8 (1996).

3. *New Energy Co. v. Limbach*, 486 U.S. 269, 273-4 (1988).

Clause forbids unreasonable restraints on interstate trade unless Congress "explicitly and unmistakably" authorizes such state regulation.[4] State regulatory authority over electricity prices is not immune from Commerce Clause scrutiny.[5]

Scrutiny of state economic regulation under the Commerce Clause follows a two-tiered approach. The threshold question is whether state action discriminates against interstate commerce.[6] If there is preferential treatment of in-state interests over out-of-state competitors, then the "strictest scrutiny" applies.[7] The statute must serve permissible ends and adequate non-discriminatory means must be unavailable.[8]

If, however, the statute is neutral on its face, having only "incidental effects" on interstate commerce, it satisfies the Commerce Clause only if the burden it imposes on interstate commerce is not "clearly excessive" in relation to the local

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4. *Fort Gratiot Sanitary Landfill v. Michigan Dept. of Natural Resources*, 504 U.S. 353, 359 (1992) ("Commerce clause prohibits States from advancing their own commercial interests by curtailing the movement of articles of commerce, either into or out of the state"); *See also, New Energy Co. v. Limbach*, 486 U.S. 269, 273 (1988); *C & A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 408 (1994). (O'Conner, J. concurring)

5. *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Comm'n*, 461 U.S. 375, 391 (1983). (Some utility rate structures would violate the Commerce Clause.)

6. *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979).

7. *Maine v. Taylor*, 477 U.S. 131, 138 (1986).

8. *Id.*

benefits.[9] In this calculus, the nature of the local interest, the amount of the burden on interstate commerce, and the availability of alternative means are considered.[10]

While states are generally free to enact laws that protect public health, safety and welfare, any regulation with a protectionist purpose is *per se* invalid.[11] For example, in *Wyoming v. Oklahoma*,[12] state law required that 10% of all coal burned in electricity plants within the state be mined in Oklahoma.[13] The state argued its purpose was irrelevant because its ability to regulate electricity prices within the state under the Federal Power Act included the ability to regulate fuel composition.[14] The Supreme Court struck down the law concluding that it discriminated against interstate commerce by foreclosing a segment of the Oklahoma coal purchasing market to all coal mined outside Oklahoma.[15]

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9. *Pike v. Bruce Church Inc.*, 397 U.S. 137, 142 (1970); *See also, Fort Gratiot*, 504 U.S. at 358-61.

10. *City of Philadelphia v. New Jersey*, 437 U.S. 617, 623-624 (1978).

11. *See, Id.* at 624.

12. *Wyoming v. Oklahoma*, 502 U.S. 437 (1992).

13. *Wyoming v. Oklahoma*, 502 U.S. 437, 443-44 (1992). *See also, Alliance for Clean Coal v. Miller*, 44 F.3d 591 (7th Cir. 1995); *Alliance for Clean Coal v. Bayh*, 72 F.3d 556 (7th Cir. 1995)

14. *Wyoming v. Oklahoma*, 502 U.S. at 457-458.

15. *Wyoming v. Oklahoma*, 502 U.S. at 455.

Appendix F

Discriminatory effects also trigger strict scrutiny. For example, in *West Lynn Creamery v. Healy*,[16] the Supreme Court struck down a Massachusetts assessment on milk sales to local retailers within the state.[17] While the statute applied to all milk distributors, whether in-state or out-of-state, the effect of the statute was to subsidize local milk farmers where the revenues stemming from the assessment were distributed only to Massachusetts milk farmers.[18] The effect was to protect local, high-cost milk producers from the effects of free market competition.[19] The Commerce Clause forbids such flagrant discrimination whether stated in or implied by state legislation.

With the repeal of monopoly status,[20] Pennsylvania's stranded cost schemes violate the dormant Commerce Clause. The mechanism for assessment under the Competition Act, whether it be the Competitive Transition Charges (CTC) or the Intangible Transition Charges (ITC), is a charge on transmission service or on local distribution service. Therefore, the analysis of the Competition Act should follow *West Lynn Creamery* closely. The two schemes are indistinguishable in structure, purpose and effect. Like *West Lynn Creamery*, a CTC and ITC

16. *West Lynn Creamery v. Healy*, 512 U.S. 186 (1994).

17. *Id.* at 192.

18. *Id.* at 194.

19. *Id.* at 197.

20. Protection from the full force of the Commerce Clause may exist in explicitly non-competitive markets, with captive customers provided a bundled service under active regulation by the state. *See, General Motors v. Tracy*, 117 S.Ct. 811 (1997).

can be levied on all sales within the state, with the proceeds funneled back only to in-state producers. Each statute has the purpose and effect of protecting high-cost, in-state industries from free market competition. As a result, the Competition Act and PECO's request thereunder are unconstitutional under the Commerce Clause in a deregulated market.

Argument

The Pennsylvania Competition Act provides a recovery mechanism for Pennsylvania electric utilities to recoup so-called stranded costs, to-wit: costs which, in a competitive retail marketplace, may not be readily recovered from previously captive customers. This recovery mechanism assesses from these customers charges for transmission or local distribution service through a Competitive Transition Charge (CTC) or an Intangible Transition Charge (ITC). In the current case, approval of PECO's request would result in an irrevocable ITC to support $3.6 billion in securitized stranded costs. Allowing incumbent Pennsylvania electric utilities to recover these so-called "stranded costs" through these charges, which cannot be applied to benefit non-incumbent electricity suppliers, provides preferential regulatory treatment in violation of the Commerce Clause's prohibition of discrimination in interstate commerce.

Specifically, the United States Constitution provides, at Art. 1, §8, cl. 3, that "Congress shall have Power . . . to regulate Commerce with foreign Nations, and among the several States, and with the Indian Tribes." While framed as a grant of power to Congress, it is firmly settled that the "dormant" aspect of the Commerce Clause prohibits states from discriminating

against interstate commerce.[21] *Fort Gratiot Sanitary Landfill, Inc. v. Michigan Department of Natural Resources*, 504 U.S. 353, 359 (1992); *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 273 (1988); *H.P. Hood & Sons, Inc. v. Du Mond*, 336 U.S. 525, 535 (1949) (characterizing it as one of the "great silences of the Constitution.") "This negative aspect of the Commerce Clause prohibits economic protectionism — that is, regulatory measures designed to benefit in-state economic interests by burdening out-of-state competitors." *New Energy, supra.*, 486 U.S. at 273-74. The regulatory measures instituted by PECO's request under the Competition Act are precisely the type of economic protectionism prohibited by the Commerce Clause.

Protectionist laws such as the Competition Act are subject to a *per se* rule of invalidity. *See, Brown-Forman Distillers Corp. v. New York State Liquor Authority*, 476 U.S. 573, 579 (1986) ("When a state statute directly regulates or discriminates against interstate commerce, or when its effect is to favor

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21. In this respect, the Commerce Clause is fundamental to our constitutional form of government. As the Supreme Court stated in *Hughes v. Oklahoma*, 441 U.S. 322, 325-26 (1979), the Commerce Clause reflects "a central concern of the Framers that was an immediate reason for calling the Constitutional Convention: the conviction that in order to succeed, the new Union would have to avoid the tendencies toward economic Balkanization that had plagued relations among the Colonies and later among the States under the Articles of Confederation." *Accord H.P. Hood & Sons, Inc. v. DuMond*, 336 U.S. 525, at 534 (1992) ("No other federal power was so universally assumed to be necessary, no other state power was so readily relinquished.,") *See also, Ben Wolf Truck Lines v. Bailey*, 1021 Ind. App. 208, 211, 1 N.E.2d 660, 661 (1936) ("There is no doubt but that the power to regulate commerce between the states is exclusively lodged in Congress, and that the state legislatures have no right whatever either to burden or to restrict it.")

in-state economic interests over out-of-state interests, we have generally struck down the statute without further inquiry."); *City of Philadelphia v. New Jersey*, 437 U.S. 617, 624 (1978). ("Thus, where simple economic protectionism is effected by state legislation, a virtually *per se* rule of invalidity has been erected.")

The United States Supreme Court has established a two-tiered test under the Commerce Clause by which legislation that facially discriminates against interstate commerce is subject to a more exacting standard than statutes that merely affect commerce indirectly. *Healy v. Beer Institute*, 491 U.S. 324, 337 (1989); *Brown-Forman Distillers, supra.*, 476 U.S. at 578-79. Legislation that discriminates against interstate commerce is unconstitutional unless it is justified by a legitimate factor unrelated to economic protectionism and nondiscriminatory alternatives are absent. *Chemical Waste Management, Inc. v. Hunt*, 504 U.S. 334, 344 (1992); *Healy, supra.*, 491 U.S. at 340-41; *New Energy, supra.*, 486 U.S. at 274. *See also, Hughes, supra.*, 441 U.S. at 337 ("At a minimum such facial discrimination invokes the strictest scrutiny of any purported legitimate local purpose and of the absence of nondiscriminatory alternatives.")

By discriminating against interstate commerce on their face, the provisions of the Competition Act would violate the Commerce Clause even if there were some non-protectionist purpose being advanced. *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 270 (1984) ("A finding that state legislation constitutes economic protectionism may be made on the basis of *either* discriminatory purpose . . . *or* discriminatory effect") (citations omitted, emphasis added); *Hughes, supra.*, 441 U.S. at 337 ("Such facial discrimination by itself may be a fatal

defect, regardless of the state's purpose"); *City of Philadelphia, supra.*, 437 U.S. at 626-27 ("But whatever New Jersey's ultimate purpose, it may not be accomplished by discriminating against articles of commerce coming from outside the State unless there is some reason, apart from their origin, to treat them differently.")[22]

Protecting a local industry or the state economy is not, for purposes of Commerce Clause analysis, a legitimate state purpose. As Justice Cardozo explained in *Baldwin v. G.A.F. Seelig, Inc.* 294 U.S. 511, 523 (1935):

> Let such an exception be admitted, and all that a state will have to do in times of stress and strain is to say that its farmers and merchants and workmen must be protected against competition from without, lest they go upon the poor relief lists or perish altogether. To give entrance to that excuse would be to invite a speedy end of our national solidarity. The Constitution was framed under the dominion of a political philosophy less parochial in range. It was framed upon the theory that the peoples of the several states must sink or swim together, and that in the long run prosperity and salvation are in union and not division.

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22. *See also, Government Suppliers Consolidating Services, Inc. v. Bayh*, 975 F.2d 1267, 1279 (7th Cir. 1992), *cert. denied*, 113 S.Ct. 977 (1993) (striking down Indiana legislation imposing regulatory burdens on importation of out-of-state municipal waste: "We need not ascribe a motive of economic protection to the Indiana legislature in order to determine that the statute is discriminatory."); *Allen v. Van Buren Township of Madison County*, 243 Ind. 665, 677, 184 N.E.2d 25, 31 (1962), *modified on other grounds*, 189 N.E.2d 816 ("This court is not yet ready to adopt the philosophy that the end justifies the means, and we refuse to decide constitutional questions upon such a basis.")

Appendix F

A desire to keep industry within the state or to promote local employment cannot justify protectionist legislation. *City of Philadelphia, supra.*, 437 U.S. at 627; *Pike, supra.*, 397 U.S. at 146. It is irrelevant whether the affected industry is characterized as "thriving" or "struggling," or whether the motivation was to aid local producers rather than harm out-of-state producers. *Bacchus Imports, supra.*, 468 U.S. at 273. Regardless of how characterized, state law protecting in-state economic interests is prohibited by the Commerce Clause.[23]

The degree to which state law protects so-called state interests or otherwise affects interstate commerce does not insulate such laws from scrutiny. The Supreme Court held in *New Energy, supra.*, 486 U.S. at 275, it makes no difference under the Commerce Clause whether the statute results in "total elimination" or simply places out-of-state producers at a "substantial commercial disadvantage:" "The present law likewise imposes an economic disadvantage upon out-of-state sellers; and the promise to remove that if reciprocity is accepted no more justifies disparity of treatment than it would justify categorical exclusion." *See also, Healy, supra.*, 491 U.S. at 341

23. *See also, Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 43-44 (1980) ("In almost any Commerce Clause case it would be possible for a State to argue that it has an interest in bolstering local ownership, or wealth, or control of business enterprise. Yet these arguments are at odds with the general principle that the Commerce Clause prohibits a State from using its regulatory power to protect its own citizens from outside competition."); *Polar Ice Cream & Creamery Co. v. Andrews*, 375 U.S. 361, 377 (1964) (rejecting assertion that "a State may preempt its market for its own producers to the exclusion of production from other areas"; "[T]he State may not, in the sole interest of promoting the economic welfare of its dairy farmers, insulate the Florida milk industry from competition from other states.")

(striking down price regulations that create a "substantial disincentive for companies doing business in Connecticut to engage in interstate commerce"); *Bendix Autolite Corp. v. Midwesco Enterprises, Inc.*, 486 U.S. 888, 894 (1988) ("In this manner the Ohio statute imposes greater burden on out-of-state companies than it does on Ohio companies, subjecting the activities of foreign and domestic corporations to inconsistent regulations."); *Maryland v. Louisiana*, 451 U.S. 725, 760 (1981) ("We need not know how unequal the Tax is before concluding that it unconstitutionally discriminates.")

The Commission's regulatory involvement in the protectionist scheme provides no salvation. *See, Brown-Forman, supra.*, 476 U.S. at 582, n.5 ("The protections afforded by the Commerce Clause cannot be made to depend on the good grace of a state agency."); *New England Power Co. v. New Hampshire*, 455 U.S. 331, 339 (1982) ("The order of the New Hampshire Commission, prohibiting New England Power from selling its hydroelectric energy outside the State of New Hampshire, is precisely the sort of protectionist regulation that the Commerce Clause declares off-limits to the states.")

Likewise, the Commerce Clause applies without regard to the nature of the state's interest. "Our constitutional review of state utility regulation in related contexts has not treated it as a special province insulated from our general Commerce Clause jurisprudence." *Arkansas Electric Cooperative Corp., supra.*, 461 U.S. at 391. *See also, Wyoming, supra.*, 502 U.S. at 455-57; *New England Power, supra.*, 455 U.S. at 338-44. Nor does a state's interest in its natural resources constitute a special justification for discriminatory legislation. *New England Power, supra.*, 455 U.S. at 338 ("Our cases consistently have held that

the Commerce Clause of the Constitution, Art. 1, §8, cl. 3, precludes a state from mandating that its residents be given a preferred right of access, over out-of-state consumers, to natural resources located within its borders or to products derived therefrom.") *See also, City of Philadelphia, supra.*, 437 U.S. at 627; *Commonwealth of Pennsylvania v. State of West Virginia*, 262 U.S. 553, 598-600 (1923).

Even if the Competition Act did not, on its face, discriminate against interstate commerce, the Act would still violate the Commerce Clause because the statutory provisions as *applied* by PECO are unquestionably discriminatory and protectionist. *See, Secretary of State of Maryland v. J. H. Munson Co.*, 467 U.S. 947, 964-65 (1983) (facially valid statute may be unconstitutional as applied); *Chaffin v. Nicosia*, 261 Ind. 698, 702, 310 N.E.2d 867, 870 (1974) ("However, a determination that a statute is constitutionally valid on its face does not end judicial inquiry into its application to particular facts.") *See also, St. Joseph County v. Wilmes*, 428 N.E.2d 103, 105 (Ind.Ct.App. 1981); *Department of Insurance v. Schoonover*, 225 Ind. 187, 191, 72 N.E.2d 747, 749 (1947); *State v. International Harvester Co.*, 216 Ind. 463, 470, 25 N.E.2d 242, 245 (1940).

In *New England Power, supra.*, the United States Supreme Court reversed an order by the New Hampshire Public Utilities Commission directing a utility to sell its hydroelectric energy to in-state concerns. 455 U.S. at 333-38. "The Commission has made clear that its order is designed to gain an economic advantage for New Hampshire citizens at the expense of New England Power's customers in neighboring states." *Id.* at 339. The conclusion in *New England Power* is equally appropriate to this case: "Such state-imposed burdens cannot be squared

with the Commerce Clause when they serve only to advance 'simple economic protectionism.' " *Id.* (quoting *City of Philadelphia, supra.*, 437 U.S. at 624)

Most on point to the situation presented by the Competition Act and PECO's request is the 1994 case of *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994). There the Supreme Court explained:

> And if a discriminatory tax rebate is unconstitutional, Massachusetts' pricing order is surely invalid; for Massachusetts not only rebates to domestic milk producers the tax paid on the sale of Massachusetts milk, but also the tax paid on the sale of milk produced elsewhere. The additional rebate of the tax paid on the sale of milk produced elsewhere in no way reduces the danger to the national market posed by tariff-like barriers, but instead exacerbates the danger by giving domestic producers an additional tool with which to shore up their competitive position.

512 U.S. at 197 (footnotes omitted). The Court held that payment to the local incumbents from the Dairy Stabilization Fund, which is functionally similar to the CTC and ITC under the Competition Act, was prohibited.

> A pure subsidy funded out of general revenue ordinarily imposes no burden on interstate commerce, but merely assists local business. The pricing order in this case, however, is funded principally from taxes on the sale of milk produced in other states.

512 U.S. at 199 (footnotes omitted). Indeed, the inherent dangers in state legislative subsidy schemes like the CTC and ITC were addressed by the Court:

> By conjoining a tax and a subsidy, Massachusetts has created a program more dangerous to interstate commerce than either part alone. Nondiscriminatory measures, like the evenhanded tax at issue here, are generally upheld, in spite of any adverse effects on interstate commerce, in part because "[t]he existence of major in-state interest adversely affected . . . is a powerful safeguard against legislative abuse." *Minnesota v. Clover Leaf Creamery Co.*, 449 US 456, 473, n 17, 66 L Ed 2d 659, 101 S Ct 715 (1981); see also *Raymond Motor Transportation, Inc. v. Rice*, 434 US 429, 444, n 18, 54 L Ed 2d 664, 98 S Ct 787 (1978) (special deference to state highway regulations because "their burden usually falls on local economic interests as well as other States' economic interests, thus insuring that a State's own political processes will serve as a check against unduly burdensome regulations"); *South Carolina State Highway Dept. v. Barnwell Bros., Inc.*, 303 US 177, 187, 82 L Ed 734, 58 S Ct 510 (1938); *Goldberg v. Sweet*, 488 US 252, 266, 102 L Ed 2d 607, 109 S Ct 582 (1989). However, when a nondiscriminatory tax is coupled with a subsidy to one of the groups hurt by the tax, a state's political processes can no longer be relied upon to prevent legislative abuse, because one of the in-state interests which would otherwise lobby against the tax has been mollified by the subsidy. So, in this case, one would ordinarily have expected at least

> three groups to lobby against the order premium, which, as a tax, raises the price (and hence lowers demand) for milk: dairy farmers, milk dealers, and consumers. But because the tax was coupled with a subsidy, one of the most powerful of these groups, Massachusetts dairy farmers, instead of exerting their influence against the tax, were in fact its primary supporters.

512 U.S. at 199-201 (footnotes omitted)[24].

Discrimination in favor of incumbent Pennsylvania electric utilities is plain from the effects of the Competition Act. It cannot be construed as anything other than unconstitutional economic protectionism. In the final analysis, the CTC and ITC provisions of the Act cannot withstand constitutional scrutiny. Even PECO's witness Heironymus recognized that generally subsidizing domestic producers to give them additional tools with which to shore up their competitive position is not only a harm to competition but also the "thing that's prohibited by the Commerce Clause." [R 807-808][25] The factual record for injury to out-of-state electric competitors is complete and copious [Brehm Direct, pp. 4-8, 14; Mendl Direct, pp. 9-10;

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24. Given the controversy over the procedure followed in enactment of the Competition Act, the risks identified by the Court loom large. *See, e.g., Verified Petition, Fumo, et al. v. Penn PUC, Commonwealth Court*, filed March 18, 1997.

25. Dr. Heironymus' assertion that such a violation would probably not apply in the case of electricity because the subsidy would not affect market price is both legally and factually in error. *See, West Lynn Creamery, Inc. v. Healy*, 512 U.S. at 195, 196. *See also*, pp. 37-42 hereafter.

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R 1240-1244; Lewellen Direct, p. 16; *see also*, IPL Administrative Notice 1]. Given both the facts the law, the Constitution compels the Commission decline PECO's request to burden interstate commerce by imposition of the ITC or any CTC charges under the Competition Act.

APPENDIX G — EXCERPTS OF BRIEF OF PETITIONER INDIANAPOLIS POWER & LIGHT COMPANY

IN THE COMMONWEALTH COURT OF PENNSYLVANIA

No. 1597 C.D. 1997

INDIANAPOLIS POWER & LIGHT COMPANY,

Petitioner,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,

Respondent.

BRIEF FOR PETITIONER INDIANAPOLIS POWER & LIGHT COMPANY

Petition For Review Of the Order Of The Pennsylvania Public Utility Commission Entered May 22, 1997 At Docket Nos. R-00973877, R-00973877C0001 and R-00973877C0002

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* * *

III. STATEMENT OF QUESTIONS INVOLVED

1. Do the stranded cost provisions of the Electricity Generation Customer Choice and Competition Act, 66 Pa. C.S. §§ 2801, *et seq.*, on their face and as applied by the Commission violate the Commerce Clause of the Constitution of the United States? The Commission initially stated it would not have authority to address constitutional challenges to the statute (Order at 17-18, R. 18a-19a), but later in its Order the Commission summarily addressed and rejected a Commerce Clause challenge by another party (Order at 22, R. 23a).

2. Are the unconstitutional stranded costs provisions of the Electricity Generation Customer Choice and Competition Act severable from the remainder of the Act? The Commission did not address this question.

* * * *

APPENDIX H — EXCERPTS OF PETITION FOR ALLOWANCE OF APPEAL

IN THE SUPREME COURT OF PENNSYLVANIA
MIDDLE DISTRICT

No. ____ M.D. ALLOCATUR
DOCKET 1998

INDIANAPOLIS POWER & LIGHT COMPANY,

Petitioner,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION,

Respondent,

and

PECO ENERGY COMPANY,

Intervenor.

PETITION FOR ALLOWANCE OF APPEAL

Petition for Allowance of Appeal from the Order of the Commonwealth Court under No. 1597 C.D. 1997 dated May 7, 1998, Affirming the Order of the Pennsylvania Public Utility Commission Entered May 22, 1997, at Docket Nos. R-00973877, R-00973877C001 and R-00973877C002.

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Appendix H

* * *

QUESTION PRESENTED FOR REVIEW

The Commonwealth Court held that the Commission's Order and the stranded cost provisions of the Electricity Generation Customer Choice and Competition Act, 66 Pa. C.S. §§ 2801 *et seq.*, which require electricity consumers to pay a portion of the incumbent Pennsylvania utility's electric generation costs when they buy their electricity from a competing supplier, do not discriminate against interstate commerce in violation of the Commerce Clause of the United States Constitution. The question presented is whether this holding is in error and conflicts with United States Supreme Court precedent.

* * * *

APPENDIX I — EXCERPT OF TESTIMONY OF JOHN R. BREHM

[commencing at page 4]

Q6. Mr. Brehm, why is an Indiana-based electric utility concerned about the securitization and recovery of $3.6 billion of alleged stranded costs by PECO?

(a) IPL's interest is direct and substantial. In the past, under monopoly regulation and with limited competition, the extent to which another utility was granted rates to achieve given levels of cash flow by regulators was of only very limited concern to IPL. However, as the electric utility industry transitions to competition, the issues of unfair, subsidized competition are presented. In PECO's case, it is clearly presented by the current request to securitize approximately $3.6 billion of so-called stranded cost.

In this case, PECO's request is based upon an assertion that PECO is due payment, up front, for all past and future "costs" PECO alleges it has or may incur by operating its existing generation in a competitive market, which "costs" may not be received in the future by PECO under hypothetical future market prices for power. Notably the hypothetical future market price postulated by PECO is currently below the long-run marginal cost (LRMC) of producing power to the grid.

Granting PECO's request would, of course, represent a gigantic subsidy for PECO in a competitive environment, even if PECO's calculation of past and [5] future "cost" and future market prices were

correct, which they are not. Other competitors like IPL, based outside of Pennsylvania, would not receive these subsidies. To the extent the Commission subsidizes the capital and operating costs of PECO units, PECO is thereby afforded the opportunity to sell power at prices well below PECO's cost, and substantially below LRMC, thus harming both its out-of-state competitors and competition itself. Such subsidies represent barriers to entry to non-subsidized, out-of-state competitors.

In essence, PECO seeks recovery of all of its generation asset costs up front, *and* the right to keep title to those assets *and* the ability to compete with those assets. Even for efficient companies like IPL, which own generation facilities with relatively low sunk costs and low operating costs, the effects of subsidies like those requested by PECO will be devastating in a competitive environment. The subsidies to PECO and presumably other Pennsylvania companies will drive the value out of non-subsidized generation assets and will produce subsidized, distorted power markets.

* * * *

(2)

Supreme Court, U.S.
FILED
FEB 1 1999
CLERK

No. 98-1065

IN THE

Supreme Court of the United States

OCTOBER TERM, 1998

INDIANAPOLIS POWER & LIGHT COMPANY,

Petitioner,

vs.

PENNSYLVANIA PUBLIC UTILITY COMMISSION
and PECO ENERGY COMPANY,

Respondents

ON PETITION FOR WRIT OF CERTIORARI
TO THE COMMONWEALTH COURT
OF PENNSYLVANIA

BRIEF IN OPPOSITION FOR RESPONDENT PECO ENERGY COMPANY

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QUESTION PRESENTED

Whether Pennsylvania's Electricity Generation Customer Choice and Competition Act, which opens up the retail electric market to competition and allows incumbent utilities to recover costs previously incurred by them to satisfy their statutory obligation to serve, violates the "dormant" Commerce Clause.

STATEMENT PURSUANT TO RULE 29.6

Respondent PECO Energy Company has no parent companies or subsidiary companies that are nonwholly owned.

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STATEMENT OF THE CASE

Invoking the "dormant" Commerce Clause, Petitioner challenges the constitutionality of an order of the Pennsylvania Public Utility Commission ("PPUC") allowing PECO Energy Company ("PECO") to recover from its customers certain costs that it previously incurred in meeting its state-imposed obligation to provide regulated electric service in southeastern Pennsylvania. The recovery of such costs is an integral part of the Electricity Generation Customer Choice and Competition Act, 66 Pa. Cons. Stat. § 2801 (1996) *et seq.* (the "Competition Act"), a comprehensive statutory scheme implementing competition for electric generation at the retail level in Pennsylvania.

A. The State Statutory Background Of The Challenged Order

Under the regulatory regime in place in Pennsylvania prior to enactment of the Competition Act, electric utilities were obligated to provide "bundled" services to all customers in their certificated territories.[1] As part of this statutory obligation, electric utilities were held to high standards of reliability, requiring them to build and maintain sufficient generating capacity to ensure continuous service to current customers and to meet projected future growth in demand. In addition, utilities historically have been subject to stringent rate regulation, whereby they were provided an opportunity to recover their operating costs, to earn a reasonable return on their investment and to recoup that investment over the lives of the underlying facilities.[2] This matrix of obligations and rights was summarized by the PPUC as follows:

---

1. "Bundled," in this context, refers to the three principal functions of electric utilities — the generation, transmission and distribution of electricity.

2. The development of electric utility regulation closely parallels that of the natural gas industry. This parallel is discussed at length by Justice Souter in *General Motors Corp. v. Tracy*, 117 S. Ct. 811 (1997).

> Electric utilities have invested heavily in their generation assets based on the existing system of rate base/rate of return regulation. That is to say, a utility receives a certificated service territory in which it is the supplier of power. In return it commits to build its system as necessary to serve the current and future needs of all customers in the service area. The utility is then allowed to recover the cost of the prudent investment it makes to provide such service, plus the opportunity to earn a regulated return on investment.

Report And Recommendation On the Investigation Into Retail Electric Competition, Docket No. I-940032 (Pa. P.U.C., July 3, 1996) (p. 20) ("*PUC Report On Retail Electric Competition*"), Respondents' Joint Appendix ("RJ App.") 14a. *See also Re Lukens Steel Co.*, 58 Pa. P.U.C. 256, 261 (1984), *aff'd sub nom. Lukens Steel Co. v. Pennsylvania Pub. Util. Comm'n*, 92 Pa. Commw. 530, 499 A.2d 1134 (1985) ("[W]hen a public utility is certificated to serve a particular service area, it undertakes an obligation or duty to serve this certificated area, and from this duty flows a right to serve customers desiring service within the certificated service area.").[3]

The enactment of the Competition Act in the Fall of 1996 effected a fundamental restructuring of the electric industry in Pennsylvania. The Competition Act requires that the generation

---

3. Additionally, Pennsylvania's electric utilities have been and remain the vehicle for implementing various social and public benefit programs that do not directly relate to the generation, transmission or distribution of electricity, such as financial assistance to low-income customers, customer service protection, energy efficiency and renewable energy, research and development, and public information and education. *See PUC Report On Retail Electric Competition*. RJ App. 1a-20a.

function of the electric supply industry be opened to competition. *See* 66 Pa. Cons. Stat. § 2802(13) and (14). Following a brief phase-in period, all consumers in Pennsylvania will be permitted to choose their electricity suppliers, which may include their incumbent utility, other in-state utilities, out-of-state utilities and other non-utility generators and marketers. At the same time, other aspects of Pennsylvania's electric industry will remain heavily regulated. For example, transmission and distribution services are not being opened up to competition; these functions will remain the duties of the local utility. *Id.* § 2802(16). Moreover, the local utility will remain as the "provider of last resort," acting as a default provider for customers who do not or cannot obtain an alternative supply or whose alternative supplier fails to deliver the contracted-for generation. *Id.* § 2807(e). Finally, the rates that the local utility may charge for its services are capped for prescribed periods at levels in effect on January 1, 1997. *Id.* § 2804(4).

Prior to the Competition Act, Pennsylvania's utilities prudently incurred substantial generation costs to satisfy their statutory duty to serve. Not all of these costs, which otherwise would have been recovered through regulated rates, are likely to be recoverable through market-determined prices. Recognizing that these "stranded" costs were a result of the previous regulatory structure and that the ongoing reliability of local utilities is crucial (*Id.* § 2802(12)), the Competition Act provides as follows:

> (15) In establishing the standards for the transition to and creation of a competitive electric market, heretofore, public utilities generally have had an obligation to serve customers within their defined service territories; consistent with that obligation, have undertaken long-term investments in

> generation, transmission and distribution facilities in order to meet the needs of their customers; and have entered into long-term power supply agreements as required by Federal law. In many instances, these investments and agreements have created costs which may not be recoverable in a competitive market. The commission is empowered under this chapter to determine the level of transition or stranded costs for each electric utility and to provide a mechanism, the competitive transition charge, for recovery of an appropriate amount of such costs in accordance with the standards established in this chapter.

66 Pa. Cons. Stat. § 2802(15).

The Competition Act thus provides that a utility, subject to PPUC approval, may recover its stranded costs through a "competitive transition charge" to be paid by "every customer accessing the transmission or distribution network . . . to the electric distribution company in whose certificated territory that customer is located." *Id.* § 2808(a). A utility may also invoke provisions of the Competition Act that allow it to "securitize" all or a portion of its stranded costs, subject to the PPUC's determination that doing so would be "just and reasonable" and "in the public interest." *Id.* § 2812(a)(2)(iii).[4] If a utility "securitizes," it recovers its stranded costs, less any savings achieved through the securitization process, through "Intangible Transition Charges" such as those at issue in this case.

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4. Through securitization, a utility converts its entitlement to recover stranded costs into a current, fully vested property right that may be sold or pledged as security for the issuance of "transition bonds." Because the interest rate payable on the transition bonds will likely be lower than the cost of the utility's existing capitalization, the bond proceeds must be used principally to reduce stranded costs and related capitalization. 66 Pa. Cons. Stat. § 2812(b)(2).

The Competition Act applies equally to all electric companies providing public utility service in Pennsylvania, regardless of their state of incorporation or principal place of business.[5] However, only those utilities which demonstrate that their prior investments will result in the stranding of costs are entitled to impose "competitive transition charges" or "intangible transition charges." Non-utility generators and marketers, whether resident in Pennsylvania or elsewhere, are not subject to the stranded cost provisions of the Competition Act because they have not borne public service obligations.

B. The Proceeding Before The Pennsylvania Public Utility Commission

In January 1997, PECO sought an order from the PPUC authorizing it to securitize $3.8 billion of its $7.0 billion of stranded costs. More than thirty parties intervened, representing a broad array of consumer interests, environmental groups, and prospective in-state and out-of-state competitors. An evidentiary record of several thousand pages was produced. The factual and expert testimony covered a wide range of issues, including such matters as the amount of stranded costs that PECO would actually incur, whether allowing recovery of stranded costs was likely to induce utilities to engage in anticompetitive behavior, and the details of the procedures that PECO would use to securitize its stranded cost revenue stream. Petitioner Indianapolis Power & Light Company ("Petitioner" or "IPL") participated fully in the proceeding before the PPUC and, as in this Court, argued that allowing stranded cost recovery would violate the Commerce Clause.

Following extensive evidentiary hearings and briefing, the PPUC, in May 1997, approved, in part, PECO's securitization

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5. In fact, more than half of Pennsylvania's electric utilities are part of multi-state utility systems whose parent company is either incorporated or headquartered in another state.

request. Pet. App. 39a-145a. The PPUC concluded that it was just and reasonable to allow PECO to recover $1.098 billion of the $3.8 billion in stranded costs that it sought to securitize. The PPUC further found that it was in the public interest to allow PECO to securitize those costs and to recover that securitized revenue stream from customers. In so ruling, the PPUC considered and rejected the argument that PECO's recovery of stranded costs would discriminate against other suppliers and would impose an impermissible burden on interstate commerce, concluding that "[t]here is simply no factual basis upon which to make such a determination." Pet. App. 63a.[6]

C. The Proceeding In The Commonwealth Court Of Pennsylvania

Petitioner appealed the PPUC's Order to the Commonwealth Court of Pennsylvania.[7] Petitioner argued that the Competition Act is unconstitutional under the dormant Commerce Clause insofar as it allows PECO to recover stranded costs. IPL further contended that, as a "reasonable and less discriminatory" means of achieving its objectives, Pennsylvania should have required that incumbent utilities divest the assets they use to generate electricity as a precondition to recovering stranded costs.[8] In other words, IPL maintained that any entity

6. The PPUC dismissed the Commerce Clause arguments in the process of responding to arguments advanced by a group of intervenors identified as the "Environmentalists." Pet. App. 43a.

7. In Pennsylvania, the Commonwealth Court has jurisdiction over challenges to final determinations of state agencies. 42 Pa. Cons. Stat. § 763 (1978).

8. Under the Competition Act, the PPUC may permit, but may not require, the divestiture of generation facilities. 66 Pa. Cons. Stat. § 2804(5).

that collected stranded generation costs was constitutionally compelled to refrain from competing in the developing interstate generation market.

By Opinion and Order issued May 7, 1998, the Commonwealth Court rejected Petitioner's appeal on several different grounds. First, it concluded that the Competition Act did not implicate the underlying concerns of the dormant Commerce Clause, both because the Act's overall purpose and effect was to create and foster an interstate electric generation market and because the states have been apportioned jurisdiction to regulate retail electric rates. Pet. App. 13a-22a.[9] The Commonwealth Court also pointed out that the Federal Energy Regulatory Commission ("FERC") had recognized the importance of stranded cost recovery, thereby refuting any assertion that the sole purpose of such recovery is to promote domestic industry and interfere with interstate competition. Pet. App. 25a.

Even though it found that the Competition Act did not implicate the Commerce Clause, the Commonwealth Court went on to apply the two-tiered test developed by this Court in *Pike v. Bruce Church, Inc.*, 397 U.S. 137 (1970) ("*Pike*"). Because the overall purpose and effect of the Competition Act is to promote and not interfere with interstate commerce, the Commonwealth Court reasoned that strict scrutiny was inappropriate and that the Competition Act instead should be evaluated in light of the more relaxed balancing standard articulated by this Court in *Pike*. Under that standard, a state statute will be sustained "unless the 'burden imposed on interstate commerce is clearly excessive in relation to the putative local benefits.'" Pet. App. 28a, quoting *Pike*, 397 U.S. at 142.

9. In this regard, the Commonwealth Court noted that "[t]he transition charges are nothing more than a different manifestation of the previously regulated rates." Pet. App. 16a.

Applying this test to the facts, the Commonwealth Court had no difficulty in upholding the Competition Act. Indeed, in a unanimous decision, the Commonwealth Court catalogued numerous "local interests," each of which alone would suffice to justify whatever incidental effect, if any, stranded cost recovery might have on interstate commerce. Such "local interests" included: (1) regulating retail sales by electric utilities (Pet. App. 30a); (2) preserving the viability of local transmission and distribution networks (Pet. App. 31a); (3) ensuring reliable generation service to all consumers (i.e., the incumbent utilities' "provider of last resort" responsibilities) (Pet. App. 31a); (4) providing assistance to low-income customers (Pet. App. 31a-32a); (5) assuring the safe decommissioning of nuclear power plants located in Pennsylvania (Pet. App. 32a-33a); and (6) maintaining fundamental fairness to investors and employees (Pet. App. 33a).[10]

Finally the Commonwealth Court held, as a matter of Pennsylvania law, that the stranded cost recovery provisions of the Competition Act were not severable from the remainder of the Act. Pet. App. 33a-36a. This is significant because, as the Commonwealth Court further observed, acceptance of IPL's Commerce Clause argument "would mutilate the Competition Act" and "would lead us to eradicate the very thing [competition] that gives IPL standing before this Court." Pet. App. 34a-35a.

On June 4, 1998, Petitioner sought leave to appeal the Commonwealth Court's decision to the Supreme Court of Pennsylvania. That Court denied review by *per curiam* order dated September 29, 1998. Pet. App. 145a.

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10. The Commonwealth Court also rejected Petitioner's divestiture alternative, concluding that divestiture would "jeopardize Pennsylvania's electric utility service." Pet. App. 30a.

SUMMARY OF ARGUMENT

The writ should be denied because it is not worthy of this Court's review. No conflict of authority in the lower courts has been alleged. Moreover, as the Petition plainly reveals, IPL's real complaint is not with the Commonwealth Court's articulation of the law, but instead with its failure to overturn the PPUC's factual findings.

Petitioner's reliance on this Court's decision in *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186 (1994) ("*West Lynn Creamery*") is misplaced. There is no new tax here, no subsidization designed to provide domestic industry a competitive advantage, and the Competition Act opens up Pennsylvania's borders to interstate competition in generation for the first time. As part of this effort to introduce competition, the Act properly affords electric utilities an opportunity to recover costs that they previously incurred in satisfying their statutorily mandated obligation to serve, costs they would have recovered through the regulatory process if Pennsylvania had never introduced retail competition.[11]

Nor, for that matter, is such reimbursement extended to all electric suppliers in Pennsylvania and denied all others. In contrast to *West Lynn Creamery*, the Competition Act does not draw a line at the state border. Rather, the right to claim stranded costs flows to those entities that made a commitment in the past to public utility service and that continue to operate subject to various state-imposed public service obligations. As such, utilities doing business in Pennsylvania, whether resident or not, qualify for stranded cost recovery; other suppliers that never

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11. As the Commonwealth Court observed: "[S]tranded-cost recoveries are not a fortuitous gift from the Commonwealth to PECO as IPL argues; they represent identifiable and limited reimbursements to which PECO is entitled." Pet. App. 13a.

enjoyed public utility status, whether in-state or out-of-state, do not.

IPL's assertion of "facial discrimination" fails for the additional reason that Pennsylvania's former monopoly providers are not "substantially similar entities" to those in-state and out-of-state suppliers that wish to compete against them. *General Motors Corp. v. Tracy*, 117 S. Ct. 811 (1997) ("*Tracy*"). Pennsylvania's incumbent utilities must continue to serve as "provider of last resort" for electricity in Pennsylvania; they retain the statutory duty to furnish transmission and distribution service; and they remain obligated to fund and to administer numerous social and public benefit programs. Alternative generation suppliers like IPL, on the other hand, can freely come and go based solely on their perception of the profitability of the Pennsylvania market.

Even if there were some basis for its facial challenge to the Competition Act, Petitioner's extraordinary "less restrictive alternative" — the compelled divestiture by Pennsylvania's electric utilities of their generating facilities — was expressly rejected by the Pennsylvania Legislature. Furthermore, there is no evidence in this proceeding that the forced sale of such assets would promote competition. Indeed, it is more likely that the elimination of a whole class of potential competitors — Pennsylvania's electric utilities — from the competitive generation market would have precisely the opposite effect.

Finally, this is a particularly poor vehicle for consideration of constitutional questions. There is no split of authority in the lower courts. No compelling reason is offered for this Court to intervene into a newly developing area of state economic policy. Moreover, IPL has failed to show "imminent harm" or a demonstrated intention to compete for retail customers in Pennsylvania and thus lacks standing. *Lujan v. Defenders of*

Wildlife, 504 U.S. 555, 560-61 (1992) (internal quotation omitted). The Commonwealth Court's conclusion that the stranded cost recovery provisions are not severable from the remainder of the Competition Act further undermines IPL's position. For all these reasons, the requested writ of certiorari should be denied.

REASONS FOR DENYING THE WRIT

I.

THE PETITIONER'S RELIANCE ON *WEST LYNN CREAMERY* IS MISPLACED.

This Court addressed Commerce Clause issues in the context of utility deregulation less than two years ago in *Tracy*. IPL does not suggest that any split has developed in Commerce Clause jurisprudence since that time, either among the circuits or the states. Rather, the Petition accepts (Pet. 14) that *Tracy* is "important Commerce Clause precedent[]" on utility deregulation, but argues that its import was misconstrued by the Commonwealth Court. As such, the Petitioner does not seek this Court's guidance on an unresolved or contentious issue of law, but instead claims that well-developed legal precedent was misapplied to the facts of this case.

The Commonwealth Court adhered to this Court's two-tiered analysis of Commerce Clause challenges. Pet. App. 28a. Under this approach, it must first be determined whether a statute "facially discriminates" against interstate commerce. If so, a statute will be struck down unless the state can demonstrate that the statute serves a legitimate local purpose and that such a purpose could not be served by some other reasonably available non-discriminatory means. *See C & A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 392-93 (1994); *see also*

Maine v. Taylor, 477 U.S. 131, 138 (1986); *Hughes v. Oklahoma*, 441 U.S. 322, 336 (1979).[12] If a statute is not facially discriminatory, a more deferential "balancing" test applies whereby a state statute will be nullified only if it imposes a burden on interstate commerce that is "clearly excessive in relation to the putative local benefits." *See Pike*, 397 U.S. 137, 142 (1970); *see also Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456, 471 (1981).

Petitioner, in its challenge to the Competition Act, relies almost exclusively on *West Lynn Creamery*. However, none of the factors that troubled this Court in that case are present here. To the contrary, the purpose and effect of the Competition Act is to promote competition, not impede it; no attempt has been made to subsidize domestic industry; and potential competitors are not discriminated against on the basis of state of incorporation or residence. As a consequence, the Commonwealth Court properly concluded that "the Competition Act as a whole does not discriminate in purpose or effect," Pet. App. 29a, and that this case is "factually dissimilar" from *West Lynn Creamery*. Pet. App. 14a.

In stark contrast to *West Lynn Creamery*, the recovery of stranded costs does not bestow a subsidy of any kind or advance

12. Statutes are generally found to be facially discriminatory under the Commerce Clause only in limited circumstances — where goods or services supplied by out-of-state entities are totally excluded from an in-state market, where such goods or services are subject to a greater tax burden than those of in-state entities, or where material otherwise may not be shipped out of or into the state. *See, e.g., Fort Gratiot Sanitary Landfill, Inc. v. Michigan Dept. of Natural Resources*, 504 U.S. 353 (1992) (statute banning disposal of out-of-state waste in Michigan); *Chemical Waste Management, Inc. v. Hunt*, 504 U.S. 334 (1992) (statute imposing extra fee on out-of-state waste disposed of in Alabama); *Taylor*, 477 U.S. 131 (statute prohibiting import of fish into state); *Hughes*, 441 U.S. 322 (statute prohibiting export of fish from state).

incumbent utilities' competitive position. Rather, it constitutes restitution for costs prudently incurred under a prior regulatory regime. The Commonwealth Court recognized this crucial distinction when it bluntly stated: "IPL has not convinced us that the Competition Act or the stranded-cost provisions afford any [competitive] advantage." Pet. App. 12a. Moreover, there is ample evidentiary support for PECO's contention that the combination of low entry barriers and low marginal pricing in the electric industry would negate any effort to use stranded cost proceeds for anticompetitive purposes.[13]

In addition, the Competition Act does not discriminate, facially or otherwise, between in-state and out-of-state suppliers. Instead, it draws a distinction between utilities regulated by the PPUC (i.e., firms that were obligated to construct needed facilities to serve Pennsylvania customers and that remain obligated to serve them as providers of last resort) and everyone else. Thus, when it comes to the recovery of stranded costs or the imposition of competitive transition charges, IPL and a Pennsylvania non-utility generator are treated precisely the same.

Finally, as this Court made abundantly clear in *Tracy*, "any notion of discrimination assumes a comparison of *substantially similar entities*." 117 S. Ct. 811, 824 (emphasis added).[14] Yet, in terms of their competitive posture, public utilities and other

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13. PECO presented evidence on this issue from Dr. William Hieronymus, a Ph.D. economist with specific expertise in this area. Dr. Hieronymus' testimony on this issue is reproduced in full in Respondents' Joint Appendix. RJ App. 25a-29a.

14. *Tracy* involved taxes imposed on sales of natural gas in Ohio from which local natural gas distribution companies were exempt. Proceeding cautiously against the complex historical and economic background of state regulation of retail sales of natural gas, this Court rejected a Commerce Clause challenge.

prospective suppliers could not be more dissimilar. Indeed, the Competition Act imposes substantial ongoing obligations on PECO and other incumbent utilities that are not shared by IPL or other non-utility suppliers:

- To stand as the provider of last resort for all customers in its service territory for as long as it is collecting stranded investment from its customers.[15]

- To provide universal service to low-income customers.

- To decommission nuclear plants — a task which even Petitioner recognizes as a valid state interest.

- To provide distribution and transmission services — again, Petitioner recognizes the protection of this function as a valid state interest.

And, PECO must do all of these things while laboring under statutorily imposed rate caps to which Petitioner and other competitors are not subject. 66 Pa. Cons. Stat. § 2804(4).

IPL seems to acknowledge that some level of stranded cost recovery would be lawful. In particular, Petitioner accepts that nuclear decommissioning and protecting the financial integrity of distribution and transmission services are valid local interests, but challenges the amount allocated for those purposes

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15. Subject to certain conditions being met, the PPUC may designate an entity other than the incumbent utility to serve as provider of last resort. 66 Pa. Cons. Stat. § 2807(e). To date, however, the PPUC has taken no action to relieve incumbent utilities of that responsibility.

by the PPUC. Pet. 26-27. In addition, IPL's chief financial officer testified that "IPL does not oppose stranded cost recovery per se." RJ App. 30a. Since Petitioner's assessment of the Competition Act apparently turns on the *amount* of stranded cost recovery provided, there is simply no basis for concluding that the Act violates constitutional norms as a matter of law.

In sum, this case fundamentally differs from *West Lynn Creamery* and every other decision which has found that a state law is impermissibly discriminatory or otherwise furthers improper protectionist goals. This is because the purpose and effect of the Competition Act is to promote interstate commerce by opening up Pennsylvania to competition that did not previously exist.

After concluding that the Competition Act did not facially violate the Commerce Clause, the Commonwealth Court conducted the balancing test called for in *Pike*, weighing the alleged adverse effect on interstate commerce against Pennsylvania's local interests. Based on the record before it, the Commonwealth Court found that the balance tipped decidedly in favor of sustaining the Competition Act and the Petitioner does not seriously challenge that conclusion. In any event, the particulars of such fact-specific balancing do not warrant this Court's review. *See Tracy*, 117 S. Ct. at 829. ("[T]he Court is institutionally unsuited to gather the facts upon which economic predictions can be made. . . .")

The Petitioner, in essence, seeks to have this Court judicially mandate that Pennsylvania convey the economic benefits of its new competitive regime to new market entrants while, at the same time, ignoring the economic harm caused to incumbent utilities that incurred substantial and, to date, unrecovered costs in satisfying their historic obligation to serve.

But nothing in the Commerce Clause imposes such an inequitable straightjacket on state legislatures. Rather, states maintain their flexibility under a federalist system *both* to provide the benefits of competition to consumers and to recompense utilities for prior investments made when they were regulated as natural monopolies.[16] IPL has presented no basis for this Court to forestall the states' experimentation on this issue by preventing, in the name of the Commerce Clause, any means of striking a reasonable balance between these competing economic interests.

II.

THE PETITIONER'S PROPOSED DIVESTITURE OPTION IS NOT A REASONABLY AVAILABLE, NON-DISCRIMINATORY ALTERNATIVE MEANS OF PROMOTING COMPETITION.

Petitioner has argued that the Competition Act can only be sustained if the recovery of stranded costs is conditioned on the utility's departure from the newly created competitive generation market. This option, however, cannot possibly be considered a reasonably available, non-discriminatory means of accomplishing Pennsylvania's policy goals, *see C & A Carbone*, 511 U.S. at 392, since it would effectively eliminate from the field all of Pennsylvania's incumbent electric utilities. Such exclusion would not promote competition — it would likely impede it.

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16. Indeed, a contrary ruling might well have the perverse effect of closing state borders to competition by forcing states to choose between the impermissible extremes of severely harming, if not bankrupting, those companies that have previously borne the burden of providing electricity to all customers or continuing forever a monopolistic, in-state regime.

Apart from the irony of arguing that the elimination of an interstate competitor is a remedy called for by the dormant Commerce Clause, Petitioner's insistence on divestiture is premised on assumptions unsupported by evidence proffered below. IPL did not attempt before the PPUC or the Commonwealth Court to establish that divestiture would actually be a less drastic means (in terms of its effect on interstate commerce) of achieving the Commonwealth's legitimate objectives than the means chosen in the Competition Act. Nor did Petitioner introduce evidence that divestiture would actually accomplish those objectives.[17]

If anything, the Petitioner's proposed divestiture alternative underscores the correctness of the Commonwealth Court's decision. Forcing those generators who recover stranded costs to divest themselves of their generating capacity would be completely inconsistent with the recognized purposes of the dormant Commerce Clause. Petitioner's thesis is that the best means to eradicate the effects of alleged "discrimination" between in-state competitors and out-of-state competitors is to eliminate an entire class of in-state competitors. This argument, however, completely disregards the underlying goal of vigorous competition that the Commerce Clause seeks to protect.

III.

THIS CASE IS A PARTICULARLY POOR VEHICLE FOR CONSIDERATION OF CONSTITUTIONAL QUESTIONS.

A. There Is No Conflict Of Authority In The Lower Courts

This Court's jurisprudence under the dormant Commerce Clause establishes clear lines of legal analysis, albeit analysis

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17. In fact, the record developed by IPL on the divestiture alternative comprises less than one page and is reproduced virtually in full in the Petition. Pet. 25.

that leads to different results on different fact patterns. At no point does the decision of the Commonwealth Court deviate from these clear lines or create a conflict among the lower courts — state or federal — over an issue of law that might justify this Court's attention. In its treatment of both federal law and state law, the Commonwealth Court's opinion applies established precedent, based upon the facts as found in the record. Petitioner's arguments amount to no more than a claim that the Commonwealth Court failed to see the facts as IPL sees them. This contention does not justify further review.

B. The Petition Seeks This Court's Intervention Into A Newly Developing Area Of State Economic Policy

The new interstate market that the Competition Act seeks to promote is as yet undeveloped, and its future will be shaped by economic forces not yet fully understood and, undoubtedly, technological innovations not yet foreseen. Different states will likely support this experiment in different ways. Some states will perhaps not support this incipient market at any level, but rather will continue to exercise the jurisdiction apportioned to them under the Federal Power Act to allow and regulate local monopolies over retail electric sales and access to local distribution facilities. *See* 16 U.S.C. § 824(b) (1992) (limiting federal agency authority to regulating "the sale of electric energy at wholesale in interstate commerce" and specifically recognizing state jurisdiction over "facilities used in local distribution or only for the transmission of electric energy in intrastate commerce").[18] This is not an appropriate time for

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18. This Court has described this language in the following terms:

> [W]hatever reason or combination of reasons led Congress to put the provision in the Act, we think it meant what it said by the words "but shall not have jurisdiction, except

(Cont'd)

intervention by this Court. "To stay experimentation in things social and economic is a grave responsibility. Denial of the right to experiment may be fraught with serious consequences to the Nation." *Reeves, Inc. v. Stake*, 447 U.S. 429, 441 (1980) quoting *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J. dissenting).

C. The Petitioner Has Not Established Standing

This Court is subject to the case or controversy limits of Article III of the Constitution. To satisfy that requirement, the party invoking federal judicial power must demonstrate that he has suffered "injury in fact," that the injury is "fairly traceable" to the actions of the defendant, and that the "injury will likely be redressed by a favorable decision." *Bennett v. Spear*, 117 S. Ct. 1154, 1161 (1997) (internal quotation omitted). The Petition does not allege, much less demonstrate, "injury in fact" to IPL.[19]

(Cont'd)

> as specifically provided in this Part or the Part next following . . . over facilities used in local distribution." Congress by these terms plainly was trying to reconcile the claims of federal and of local authorities *and to apportion federal and state jurisdiction over the industry.*

Connecticut Light & Power Co. v. Federal Power Comm'n, 324 U.S. 515, 530-31 (1945) (emphasis added).

19. Petitioner's standing in the earlier state proceedings does not imply standing in this Court.

> We have recognized often that the constraints of Article III do not apply to state courts, and accordingly the state courts are not bound by the limitations of a case or controversy . . . [even] when they are called upon to interpret the Constitution. . . .

(Cont'd)

IPL notes, in its Petition, that it "intervened before the [PPUC] and presented evidence that, *inter alia*, requiring consumers to pay these stranded generation cost charges to PECO would disadvantage competing producers in the market for electric generation." (Pet. 4, citing Pet. App. 259a-260a). The Petition does not assert, however, that IPL is such a competitor.[20] Rather, IPL's standing theory is simply that it might compete with PECO in the future and that it therefore has an interest in ensuring that PECO does not receive a financial benefit today that it might later use to subsidize its competitive efforts. By this logic, Petitioner would have "standing" to challenge every rate order sought by every generating utility in the country.

Article III requires more than a theoretical possibility of injury in the future. When a federal plaintiff grounds its claim to standing on anticipated future injury, it must show "that the injury complained of . . . if not actual, [is] at least *imminent*. . . ." *Lujan v. Defenders of Wildlife*, 504 U.S. 555, 564 n.2 (1992) (emphasis in original). IPL has not demonstrated an "imminent" threat that it will compete with PECO for retail

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(Cont'd)

ASARCO Inc. v. Kadish, 490 U.S. 605, 617 (1989). Thus, notwithstanding a petitioner's standing in state court, this Court will not "accept as the basis for review," a matter which does not constitute a concrete case or controversy under Article III. *See Doremus v. Board of Educ.*, 342 U.S. 429, 434 (1952).

20. IPL has not filed an application with the PPUC to do business in Pennsylvania. At the same time, more than 75 entities have been licensed by the PPUC to operate as electric generation suppliers and many of those licensees began providing service to hundreds of thousands of customers when generation competition in Pennsylvania commenced on January 1, 1999. It is therefore no answer for IPL to say that it is unwilling to commit resources to competing in Pennsylvania as long as the "unfair" stranded investment rules are in place.

sales in Pennsylvania or that PECO would use stranded cost recovery "to sell power well below PECO's cost" if IPL were to do so. Petitioner's standing depends upon both facts being true; the record before this Court supports neither.

Also troublesome, insofar as its standing in this Court is concerned, is Petitioner's failure to address the Commonwealth Court's holding that the stranded cost provisions of the Competition Act are not severable from the remainder of the Act. The notion that IPL is a potential competitor of PECO for the patronage of Pennsylvania retail electric customers is grounded entirely on the supposition that the Competition Act validly confers upon out-of-state generators the opportunity to sell electric power at retail in Pennsylvania. Indeed, the Petition does not claim that any such right would exist if the Competition Act were repealed or invalidated. At the same time, the Commonwealth Court's analysis compels the conclusion that the injury IPL complains of cannot be redressed without invalidating the Competition Act. Stated simply, if stranded cost recovery under the Competition Act were declared unconstitutional, IPL would be entirely precluded from competing for retail customers in Pennsylvania. Rather than redressing Petitioner's alleged grievance, this result would put IPL in a far worse position.

CONCLUSION

The Commonwealth Court thoroughly analyzed Pennsylvania's Competition Act, applying this Court's precedents to the record in this matter, and sustained that Act on a variety of grounds. The Petition offers no sound reason why this Court should review that clearly correct result, and the Petition For Writ of Certiorari should be denied.

Respectfully submitted,

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APPENDIX

APPENDIX A — EXCERPTS OF REPORT AND RECOMMENDATION ON THE INVESTIGATION INTO RETAIL ELECTRIC COMPETITION

Docket No. I-940032

PENNSYLVANIA PUBLIC UTILITY COMMISSION
July 3, 1996

* * *

II. BACKGROUND

At a Public Meeting held April 14, 1994, the Commission instituted an Investigation to examine the structure, performance and role of competition in Pennsylvania's electric utility industry. The Commission took this action to gather and analyze data on the electric competition issue and to present our recommendations to the Governor, General Assembly and the public. The fundamental issue is whether the electric industry can be restructured to a more competitive regime and regulation diminished in order to promote the public interest. The Commission appreciates those who participated in this Investigation and provided comments for consideration.[1]

One factor driving a move to restructuring is the disparity in electric rates and costs. There is a high disparity in retail

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1. The Commission received comments and testimony from many interested parties including rural electric cooperatives and municipal authorities throughout this Investigation. These parties made a valuable contribution to the development of this Report. They also convincingly conveyed the many differences which distinguish them from the regulated utility companies. In this light, we recognize that the recommendations of this Report are not meant to address either the cooperatives or the municipal electric systems.

electric rates across Pennsylvania and between Pennsylvania and many other states. As of January 1996, Pennsylvania residential electricity prices ranged from 6.69 to 11.58 cents per kwh. Industrial rates ranged from 4.53 to 7.13 cents per kwh. Nationwide, Pennsylvania rates are in the highest 25% of electricity rates when compared with all other states.[2]

Additionally, there is a significant difference between the marginal cost of electric power production and existing retail rates. Existing rates include the recovery of the cost of capital investments that were incurred in the past. These costs were associated with available technologies and efficiencies. Current marginal costs are significantly lower than electric energy rates primarily because of reduced capital cost, improved production efficiencies, and favorable oil and gas prices. These factors combined with federal energy policy changes, such as the 1992 Energy Policy Act, have created an environment in which more low cost generation is available.

The Commission's Investigation Order directed all jurisdictional electric utilities to file comments and requested the same of any interested party. A Commission Staff Report was issued on August 4, 1995. The completion and release of the Staff Report was an interim step in this Investigation. The Commission issued another Order on September 27, 1995, requesting parties to file testimony addressing the Staff Report and a series of questions dealing with electric competition and restructuring.

There was broad-based public participation in response to our request. Parties submitted both pre-filed, written testimony

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2. *Electric Power Monthly*, Energy Information Administration, March 1996, p. 76.

and oral testimony. Commissioners were given an opportunity to ask questions of each presenter. Following these hearings, three public input hearings were held to solicit comments from the general public. This Report is the culmination of the Investigation.

* * *

3. *Stranded Costs*

Dealing with stranded costs is one of the most difficult issues to be resolved in our efforts to move to a competitive electric utility industry. If consumer prices are to be based on market prices instead of regulated rates, market prices may not be sufficient to recover all existing utility investments and expenses. In general terms, costs currently included in rates which exceed the market value of the related asset are uneconomic. Upon the transition from regulated rates to market-based prices, uneconomic costs may become stranded to the extent that they are not recovered by market prices. These costs are in the regulated rates that consumers pay today, although they are not explicitly identified as stranded costs. If no changes in industry structure or the regulatory regime are made, consumers will continue to pay these costs over the life of the investment. Stranded costs also include expenses which were incurred during price regulation but have not yet been recovered from customers and may not be recovered under competitive market pricing.

Specifically, the Commission finds that the elements of the current utility cost structure that may be stranded fall into four categories: (1) Regulatory Assets (deferred taxes, post-retirement employee benefits, etc.), (2) Non-utility Generator

Contracts, (3) Utility Generation Assets (primarily nuclear power plants), and (4) Nuclear Decommissioning Expenses. These costs must either be mitigated by a utility as part of a transition to retail competition or recovered during a phase-in to full retail competition.

a. Mitigation of Stranded Costs. The Commission expects that the utilities will continue to identify and to take vigorous steps during the transition period to mitigate stranded costs as much as possible. "Mitigation" is a broad term which includes any action that a utility might take to reduce stranded costs. Utilities should take notice that, as of the date of this Report, companies should take actions to improve their competitive position and to reduce their risks. The Commission supports transition policies that address and mitigate stranded costs as an important step in promoting competition in the electricity market. But mitigation strategies must not result in an increase in either (1) base rate charges by customer class during the transition period, or (2) Energy Cost Rate (ECR) charges, with the exception of the impact of PURPA-related projects. As the Commission reviews actual mitigation efforts of each utility in determining a reasonable stranded cost recovery amount, we will consider the burden of mitigation efforts on consumers and shareholders alike.

The Commission will provide accounting flexibility in support of mitigation measures such as accelerated depreciation, debt level buy downs, and regulatory asset retirement. During the transition period, electric utilities will be required to submit plans to the Commission for mitigation. At the milestone reviews, each utility's mitigation strategies and results will be evaluated.

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Several of our electric utilities are already attempting to mitigate stranded costs through a number of proposals before the Commission. The mitigation strategies filed with the Commission to date include: accelerated depreciation of utility generating facilities, renegotiation and buy-out of non-utility generator contracts, accelerated amortization of regulatory assets, and accelerated decommissioning plans. PECO Energy (PECO) and Pennsylvania Power Company (Penn Power)[9] have filed accelerated depreciation plans for their nuclear power plants. Metropolitan Edison Company (Met-Ed), Pennsylvania Power & Light Company (PP&L), and West Penn Power Company (West Penn) have petitioned the Commission for approval of buy-out proposals on a number of their non-utility generation contracts. Duquesne Light Company (Duquesne) and Penn Power have filed accelerated nuclear decommissioning plans.

A utility also can mitigate stranded costs by selling assets and using the proceeds to fund other mitigation efforts. Duquesne Light has used this strategy in the sale of its interest in the Fort Martin generating facility. Duquesne is using the profits from this sale to mitigate stranded costs by writing-off a portion of its investment in nuclear facilities, accelerating depreciation of nuclear facilities, and accelerating amortization of nuclear decommissioning expenses.

In addition, there are several other potential mitigation strategies that should be vigorously employed. Utilities can operate more efficiently and reduce operating expenses. When utilities operate generation facilities more efficiently, the

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9. Penn Power's Petition was approved by the Commission at its June 20, 1996 Public Meeting. Docket No. P-00961028.

generation from those plants is more competitive, thereby reducing potentially stranded costs. Most Pennsylvania utilities also have reduced the cost of operating local distribution and customer services. When a utility reduces operating costs for such services, it is able to continue to collect the higher cost of service in existing rates to support other expenses or dividends until such time as new rates are determined. Lastly, utilities which forego increased earning growth or reduce dividends are making a shareholder contribution to stranded cost mitigation if such resources are used to fund mitigation efforts. The Commission is particularly interested in mitigation strategies employed and will closely scrutinize these efforts in individual proceedings. In this regard, it should not be assumed that foregone earnings below authorized return on equity constitute mitigation funding absent further explanation of how earnings were applied against uneconomic costs.

Mitigation also can be accomplished if a utility chooses to write-off a portion of the book value of an asset which is above market value. The utility and its shareholders only bear the burden of such a write-off once the return of or return on that investment is no longer included in regulated rates.

Thus, "mitigation" is a broad term which includes both cost savings which benefit consumers and shareholders, and strategies which utilize existing ratepayer and/or shareholder funds for different purposes. In evaluating any mitigation strategy, it is important to assess the degree to which ratepayers, shareholders or both are bearing the burden or receiving the benefits of the mitigation activity.

As the Commission requires utilities to mitigate stranded investments vigorously and prudently and to the maximum

extent possible, the Commission will pay close attention to the benefits and to the burdens that result from each mitigation effort. Utilities which: (1) from the beginning, act more effectively to avoid uneconomic costs; (2) make greater efforts to mitigate stranded investments; and (3) bear a burden of stranded investment mitigation should be recognized for their performance through increased opportunity for recovery of non-mitigated investments.

b. Principles for Recovery of Stranded Costs. By the conclusion of the transition period, the Commission will complete its review of stranded costs that have not been successfully mitigated and will determine the level of stranded costs that will be eligible for cost recovery through a mechanism called a Competitive Transition Charge (CTC).

The CTC will not likely be the primary source of stranded costs recovery. Even if a CTC permitted utilities to recover every conceivable stranded cost, most utilities still would recover a substantial portion of uneconomic costs through regulated rates from customers who have not chosen alternative sources of generation. All consumers will continue to pay regulated rates which include uneconomic costs during the transition period before consumers are allowed to choose alternative sources of generation. Once consumers are permitted to choose an alternative generation supplier, a large portion of consumers will continue to receive generation services under existing regulated rates for some time to come. Thus, during both the transition and phase-in periods, a large portion of potentially stranded costs will be recovered directly from consumers who continue to pay regulated rates.

Utilities will be required to identify, as stranded costs recovery, an appropriate portion of the revenue stream which

it collects from customers and apply it to write-down the value of uneconomic assets. This transition will substantially reduce potential stranded costs. For example, if 40% of a utility's customers choose an alternative source of generation during the stranded costs recovery period, and therefore pay a Competitive Transition Charge (CTC), the remaining 60% of its customers will continue to pay for uneconomic investments through regulated rates.

Indeed, each public utility could have a unique financial transition plan because: (1) each has different types and levels of stranded costs, (2) each has undertaken varying efforts to avoid or reduce stranded costs, and (3) each has undertaken varying efforts to bear the burden of uneconomic costs. Further, it is important to emphasize that each electric utility will have a different level of uneconomic cost recovery from customers continuing to pay regulated rates. Different financial transition plans will directly affect the level and timing of price reduction opportunities for consumers.

While the financial transition plan may be unique for each utility, guiding principles which apply to all utilities can establish a transition which balances competing concerns of different utilities and consumers. In addition to the principles in the foregoing discussion, the Commission will consider the following principles in authorizing stranded cost recovery for each utility:

i. The financial transition principles should provide an incentive for utilities to remove stranded costs from prices as quickly as possible in order to gain the benefits of restructuring in a timely manner. In addition, utilities will experience the impact of

stranded costs on their financial condition immediately upon making the transition to competitive pricing. Thus, it is in their interest to eliminate or reduce any uneconomic costs as quickly as possible.

ii. Recovery of stranded costs must not increase prices above current rates by customer class. The transition period must permit recovery in a way which does not have a negative impact on consumers. The transition to market pricing means that some uneconomic investments which presently are being recovered over an extended period of time (perhaps 20 or 30 years) instead will be recovered in a much shorter period. A financial transition that accelerates such recovery exerts upward pressure on rates during the recovery period. The transition must be designed such that existing rates are the absolute cap for each class of consumers. As a general rule, stranded cost recovery must not result in an increase in either base rate or ECR charges during the transition period. In addition, the Commission will closely scrutinize and avoid mitigation efforts and cost recovery which shifts the burden of uneconomic costs among classes of ratepayers.

An important exception to the accelerated recovery of stranded costs is that stranded costs should not be recoverable from consumers until they are actually accrued by the utility. For example, utilities have already invested in generating facilities which are potentially stranded costs. However,

utilities have not yet actually made future non-utility generator contract payments nor nuclear decommissioning trust fund contributions. Such expenses should be collected from ratepayers as they are incurred. This principle retains payment of these expenses by consumers, just as exists now, without acceleration. A possible alternative would be for utilities to collect some future expenses at their present value.

iii. Utility recovery and consumer burdens must be shared and balanced. Fairness among utilities and between utilities and consumers requires a balanced sharing of stranded costs. Utilities should receive a reasonable opportunity for, but no guarantee of, recovery of up to 100% of net, unmitigated stranded costs.

iv. Only net stranded costs should be recoverable. Restructuring will not only reduce the value of certain utility assets, it will increase the value of other assets as well. For example, some utility assets have been fully or substantially depreciated, and therefore fully paid for, and may have significant residual value which will remain a utility asset. This residual value of generating assets must be subtracted from the stranded costs to calculate the total amount of recovery.

v. Different recovery levels should be permitted for different categories of stranded costs. Each of these categories reflect differing degrees of management responsibility for the stranded costs that may exist

and different utility benefits from costs which may now become stranded. In addition, as usually calculated, stranded costs include not only return *of* the investment (principal), but also return *on* the investment (earnings). The Commission believes this is a fundamental distinction.

vi. Stranded costs recovery must be conditioned on the reasonable availability of the asset. Any generating asset for which stranded costs are obtained must be dedicated to serving the consumers who are being required to pay for it. As such, plants must be held to an acceptable performance standard as well.

vii. Stranded costs recovery plans must contain assurances of operating safety. Utilities must not have any incentive to compromise operating safety on uneconomic assets.

viii. Stranded costs recovery plans must guard against deterioration of customer services and propose verifiable measures to remediate customer service problems.

c. Recovery of Specific Stranded Costs. In addition to uneconomic costs which will continue to be recovered by utilities from customers remaining on regulated rates, the CTC should include recovery for different types of stranded costs from customers choosing alternative generators as follows:

i. *Regulatory Assets.* As a result of this Investigation, the Commission recommends that thorough consideration be given to the level of

recovery for the generation portion of unmitigated regulatory assets on the books of the utility. Since regulatory assets represent existing deferrals of recovery for approved expenses, they should receive priority recovery under the cost recovery mechanism.

ii. *Non-utility generator (NUG) Contracts*. This category of stranded costs are agreements that utilities have with independent power producers for the purchase of energy or capacity. Some of these agreements pose a potential stranded costs problem for electric utilities because the price they pay for the power produced by these facilities may be higher than the expected market price of electricity.

These contracts became an obligation of the utilities because of a requirement by the federal government that utilities purchase power made available by qualifying facilities (QF). In 1978, Congress passed the National Energy Act (NEA) to reduce the country's dependence on foreign oil. PURPA also implements the policies of the NEA and requires electric utilities to purchase electricity from a QF based upon the utilities' avoided cost. Avoided cost is defined as the price the utility would otherwise have incurred for its power rather than purchasing it from the QF. The problem of NUG stranded costs exists because the utilities' avoided cost at the time the contracts were negotiated was based on projected substantial increases in fuel prices. However, energy prices decreased during the 1980s. The average price paid for NUG contracts is 6.10 cents per kwh. Consequently, electric utilities

must purchase power at a higher price than is currently available in the market or at prices higher than the current cost of a newly-constructed generator plant.[10]

As a result of this Investigation, the Commission recommends that utilities be authorized to collect the costs of currently effective and approved NUG contracts as they are incurred. Utilities should vigorously seek to renegotiate or to voluntarily buy-out uneconomic NUG contracts, especially contracts for facilities which have not yet been built. Since NUG contracts were required by law, utilities will have the opportunity to request recovery of the unmitigated prudent costs of such contracts within the cost recovery mechanism.

iii. *Electric Utility Generation.* The third element of identified stranded costs for electric utilities is uneconomic generation assets, primarily nuclear power plants. The seven major investor-owned electric utilities in Pennsylvania had an original cost in nuclear generation power plants of $15.6 billion. Pennsylvania's current net plant investment in nuclear power plants is $12.3 billion.[11]

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10. From 1985 through 1994, Pennsylvania's electric utilities purchased 41,331 gigawatt hours of electricity from NUGS at a cost of about $2.5 billion. The federal government and the Commission historically played a significant role in requiring jurisdictional electric utilities to purchase capacity and associated energy from NUGS.

11. *Restructuring of the Electric Power Industry in Pennsylvania*, Z. Ahmed Kaloko, Ph.D. (1995).

Appendix A

Electric utilities have invested heavily in their generation assets based on the existing system of rate base/rate of return regulation. That is to say, a utility receives a certificated service territory in which it is the supplier of power. In return it commits to build its system as necessary to serve the current and future needs of all customers in the service area. The utility is then allowed to recover the cost of prudent investment it makes to provide such service, plus the opportunity to earn a regulated return on investment.

There can be no doubt that the existing ratemaking system itself has significantly contributed to stranded utility investments. Current regulated rates are the result of the existing ratemaking rules and procedures under the Code. The wide disparity in existing rates also demonstrates that utilities made substantially different decisions and responses to the same ratemaking rules. For example, decisions to invest in nuclear power in the 1960s and 1970s have produced higher cost power than decisions to build generation which utilizes other fuels.

As a result of this Investigation, the Commission recommends that utility generation assets not mitigated during the transition period, which have book values above market, should be netted against utility generation assets that have book values below market. Any excess would then be reviewed by the Commission according to the principles contained in this Report. The Commission

will then determine a reasonable recovery amount not to exceed the net, unmitigated depreciated costs; up to 100% recovery. In addition, the allowance of a return on equity element of net stranded generation costs based upon the principles contained in this Report is one component that utilities might seek to include in their computation of stranded costs. In particular, the Commission will scrutinize a utility's efforts to mitigate stranded costs during the transition period. The Commission will also evaluate the actions taken by the utility to foster a more competitive electrical energy marketplace. It should be noted that under the current ratemaking system, the authorized return on equity established by Commission decisions may have already compensated shareholders for the business and for competitive risks inherent in their investments.

iv. *Nuclear Decommissioning Expenses*. Federal law provides that utilities which constructed nuclear generating stations must annually contribute monies to a trust fund to be applied to the decommissioning expenses associated with the plant's retirement. Consumers have been paying an amount designated to achieve this goal, although estimates of the cost of future nuclear decommissioning are accelerating rapidly. Similarly, the anticipated retirement dates for some plants have been moved up for both economic and operational reasons. Thus, decommissioning may not be fully funded absent the ability to continue to collect funds for this purpose. While utilities could be required to bear some portion of nuclear decommissioning expenses,

the need to assure safe nuclear decommissioning in the future requires that consumers continue to fund a reasonable share of prudent nuclear decommissioning expenses over the remaining life of the facility.

v. *Exclusions from Recovery*. As previously indicated, utilities should not recover any transition costs which could have been mitigated by the utility and are already recovered through a net increase in the value of other assets. Additionally, Commission-authorized recoverable stranded costs must be limited to costs which have decreased in value as a result of the change to a competitive retail generation market. Similarly, assets which have a market value that is less than book value for any reason other than the transition to retail competition should not be recoverable in the CTC. Lastly, recoverable stranded costs must not include any assets which were previously determined by the Commission not to be used and useful.

d. Recovery of Stranded Costs. It is the recommendation of this Commission that recoverable stranded costs, as determined by the Commission pursuant to the considerations outlined, should be recovered by a non-bypassable surcharge, the CTC. Use of a CTC is the most effective and fair way to recover these costs. All retail customers located in the utility's distribution service territory are expected to contribute to stranded costs recovery. By including these costs, which would be paid by all retail distribution customers for whom the costs were incurred, stranded costs would be removed from generation rates so that some presently uneconomic generation

facilities could be competitive. Additionally, since the cost of recovering the stranded costs would not be reflected in generation prices, the recovery charge would not be a barrier to choosing alternative generation suppliers.

Thus, there will be no core customers who must bear the entire ratepayer burden of stranded costs since departing ratepayers will not be able avoid such costs. Consumers who choose alternative generation suppliers will pay a CTC. Consequently, consumers remaining under regulated rates will not pay a CTC, although they will continue to pay for uneconomic costs as part of existing base rates.

e. Proceedings. The Commission will conduct hearings to examine each company's specific estimates of stranded costs and any proposed recovery mechanism for use during the phase-in period. These proceedings are designed to apply, on a case-by-case basis, the standards and guidelines expressed above.

In order to receive recovery of stranded costs or other transition costs, a utility is expected to file a Recovery Plan which: (1) establishes that the utility will cooperate with the Commission to facilitate the transition by providing necessary information, and (2) documents anticipated items and levels of stranded costs, other transition costs, offsetting increases of the value of identified assets, uneconomic costs which are recovered through base rates, mitigation strategies and anticipated recovery amounts. The Commission will review the Recovery Plan with the participation of interested parties, consistent with due process requirements, and establish a CTC. In addition to establishing anticipated stranded costs recovery through the CTC, the Commission will establish anticipated revenues in regulated rates which will be available to mitigate

stranded costs. Since actual recovery requirements will depend on market values, actual mitigation efforts and other variables, the CTC may be adjusted annually based upon updated documentation. Any transition costs not recovered within the phase-in period should not be recoverable unless otherwise authorized by the Commission.

Calculating the amount of stranded costs is a function of the market price for electricity in a competitive market. Since we do not know what the market price will be in a fully competitive market, we can only estimate the magnitude of this cost at any point in time. However, our consideration of stranded costs will be most efficient if the estimates for each utility are based on consistent definitions and methodologies.

f. Legal and Policy Issues Related to Stranded Costs. There are two primary legal issues related to stranded cost recovery. First, the Commission must have legal authority to authorize utilities to recover stranded costs. The Commission concludes that it may not have sufficiently clear legal authority to provide for the recovery of stranded costs.[12]

The second primary legal issue related to stranded cost recovery is whether the law requires any aspect of stranded cost recovery. Some utilities have argued that they are constitutionally entitled to full recovery of all stranded investment. They argue that anything less than full recovery is an unconstitutional taking of property without just compensation in violation of the Fifth Amendment. We cannot agree.

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12. *See Barasch v. Pa. Public Utility Commission*, 516 Pa. 142, 532 A.2d 325 (1987); *Duquesne Light Co. v. Barasch*, 488 U.S. 299 (1989).

Appendix A

The Commission concludes that the United States Constitution does not *require* the Commission to permit full recovery of stranded costs. The due process clause of the Constitution has been applied to prevent governmental destruction of existing economic values, but it has not been and cannot be applied to ensure values or to restore values that have been lost by operation of economic forces; thus, there is no constitutional right to recover uneconomic investments.[13]

Yet, this conclusion does not end the debate. Some utilities also argue that changing the ratemaking system raises a constitutional and basic question of fairness. This argument does have some merit. Although a utility has no constitutional right to the continued use of a particular ratemaking system, such a change does raise questions of fairness. Fairness to utilities must be balanced with fairness to consumers and the public interest requirements of lower electric prices. We must accept the fact that the restructuring we recommend does change the rules of the game after utilities made decisions and investments based on the then-existing rules.

Hence, we conclude that the law does not require any particular recovery of stranded costs.[14] Nor is stranded cost recovery, as a threshold matter or at any particular level, constitutionally mandated.

This Commission does not intend to convert the opportunity to recover stranded costs into a guarantee of recovery. Utilities

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13. *Market Street Railway Co. v. California Railroad Commission*, 324 U.S. 548 (1945).

14. *See Federal Power Commission v. Hope Natural Gas*, 380 U.S. 591 (1944) and *Bluefield Water Works and Improvement Co. v. Public Service Commission*, 262 U.S. 679 (1923).

should have a reasonable opportunity to recover stranded costs based on the principles outlined in this Report. We believe that this outcome is constitutionally permitted, although it is not constitutionally required.

The Commission will determine that just and reasonable rates are to be determined primarily through market pricing. The Commission will balance the interests of consumers and shareholders on a case-by-case basis. Moreover, under an acceptable stranded costs recovery plan, the incumbent utility will have the burden to demonstrate that the stranded costs are verifiable, prudently incurred and that mitigation efforts will be as vigorous as possible.

We recognize that to move the full competition without making a provision for stranded costs recovery could provoke costly, reform-delaying litigation. These factors may invariably reduce the quality of electric service and delay the arrival of the benefits of competition. Delay and litigation are certainly not in the public interest.

Acceptance of all of the foregoing concerns warrants that we balance fairness to the utilities and to ratepayers so that the burden of stranded costs is appropriately shared. However, the Commission concludes that utilities should have an opportunity to seek recovery of up to 100% of net, unmitigated stranded costs during the phase-in period from regulation to competition in the electric generation sector. We encourage the General Assembly to provide explicit authority for the Commission to permit recovery of a reasonable portion of stranded costs based upon the principles outlined in this Report. In particular, the "used and useful" standard, enunciated in Section 1315 of the Code can be amended to permit reasonable recovery of stranded costs.

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APPENDIX B — BRIEF OVERVIEW OF SECURITIZATION BY KENNETH ROSE

The National Regulatory Research Institute
The Ohio State University

The Process

An often discussed means of dealing with potential electric utility "stranded costs" is securitization. Securitization refers to the creation of a financial security or bond that is backed by a revenue stream pledged to pay the principal and interest of that security. This device provides utilities an up-front, lump-sum payment from the sale of the security. Securitization requires the creation of a transferrable property right (thus far, through legislation) to collect from the utility's ratepayers a "customer transition charge" or through some other "non-bypassable" obligation placed on ratepayers. The charge is usually, but not always, based on some portion of the utility's "stranded" or uneconomic costs. If this option is exercised by the utility, the property right can be transferred by the utility to a designated trustee, a "bankruptcy remote special purpose entity." The trustee then issues a bond and pays the utility the cash proceeds from the sale of the security in the financial market less transaction costs. The securitized bondholders then have the right to collect the charge from the utility's customers that are obligated to pay it. The utility or distribution company collects the customer charge from the customers and transfers the funds to the trustee that then transfers it to the securitized bondholders. The cash proceeds the utility receives should equal the discounted present value of the customer charge revenue stream.

Appendix B

Current State Action

Currently, California, Pennsylvania, Montana, Illinois, Massachusetts, Rhode Island, and Connecticut have adopted legislation that allows utilities to use this option and other states are considering it. In December 1997, three investor-owned utilities in California issued a total of $6.1 billion in securitized bonds (these companies have been authorized by the California Public Utilities Commission to issue up to $7.3 billion).

Advantages

The securities are essentially backed by a pledge that the securities will be paid in full, including principal, interest, and financing costs. These securities have a value because of the promise to create and sustain the revenue stream from the customer charge until the debt is paid. The bonds are evaluated for investment purposes based on the strength of this pledge and the likelihood that the revenue stream to the bondholders will be sustained throughout the term of the bonds. The benefits of securitization come primarily from the replacement or refinancing of the utility's existing capital structure of debt and equity with lower-cost debt. Any savings realized from securitization are often required to be given back to retail customers in the form of either a rate reduction or a reduction in the amount of recoverable "stranded cost."

Limitations

While securitization can potentially lower the capital carrying cost, there are at least three significant drawbacks for customers. First, to obtain a higher bond rating than current utility debt and realize the lower debt cost, any securities issued

would have to be irrevocable and assurances given that recovery is guaranteed for the life of the bond. Securitization provisions usually contain a true-up mechanism that raises or lowers the customer charge to adjust for changes in the number of customers or demand level. However, the amount initially set as the principal of the bond cannot be changed. This may be a problem if the actual amount of competitive loss is less than the amount forecasted when the principal was authorized. Estimates of a utility's competitive loss are based on dozens of explicit and implicit assumptions used in the analysis, any number of which may turn out to be incorrect. In addition, the estimated results are highly sensitive and change substantially when there are only slight changes in the assumptions. This represents a significant risk for customers who would have no recourse if the loss does not materialize as expected. In some cases, no loss may appear at all and the company may actually realize a financial gain.

A second limitation is that securitization results in a large infusion of cash into the utility. A state may be able to require that the cash will be used to buy back equity and reduce debt; however, in a holding company structure the utility can simply transfer the cash to the holding company. This money can be used in any manner the holding company desires, including using it to restrict competition. This would be a special advantage granted to the incumbent utility and could be used for anticompetitive purposes.

A third limitation is also related to the irrevocableness of the bond. Generally, in either a competitive market or in regulated industries, the appropriateness of a firm's costs is disciplined and monitored by the market or, however imperfectly, a regulator. Under regulation, utility costs are

subject to possible review (through prudence or used and useful tests) by the regulator. Of course, in a competitive market risks are usually placed on the company and its investors and provide a strong incentive to control costs to remain competitive. Securitization limits the ability of both the market and the regulator to discipline or revisit securitized costs and determine the appropriateness of recovery when future market conditions change. This transfers significant risk to utility customers that were once borne by the utility under regulation or that would occur in a competitive generation market. This is the primary reason for the perceived lower risk to the utility (and the resulting lower cost of capital) associated with securitization when compared to ordinary utility debt refinancing.

APPENDIX C — EXCERPT OF TESTIMONY OF DR. WILLIAM HIERONYMUS REGARDING MARKET PRICES FOR PECO ENERGY GENERATION BEFORE THE PENNSYLVANIA PUBLIC UTILITY COMMISSION

APPLICATION OF PECO ENERGY COMPANY FOR ISSUANCE OF A QUALIFIED RATE ORDER UNDER SECTIONS 2808 AND 2812 OF THE PUBLIC UTILITY CODE

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The Effect Of Stranded Cost Recovery on Competition

Q. **Mr. Brehm asserts that if PECO and other Pennsylvania utilities are allowed to recover their stranded costs, and particularly if stranded cost recovery is based on projected market prices that are below long run marginal costs, then out-of-state competitors and competition will be harmed. Do you agree?**

A. No. It is important, first, to be aware that competitive prices are based on short run marginal costs. They also may equal, and indeed will tend over the long term toward, long run marginal costs. However, at any point in time, the price in the market will be set by the short run marginal cost of the most expensive (in terms of marginal cost) generation required to meet load. This is basic economics. The reasoning, quite simply, is that all producers will wish to sell all output for which they can make a contribution to fixed cost and profit. Stated otherwise, the refusal to sell output when the market price is above marginal cost will reduce profits by the amount of such contribution that would have been earned on the output. Competition among sellers, all of whom face these same incentives, will drive

the price down to the highest marginal cost of output demanded by consumers at that point in time.

Short run marginal cost is the variable operation and maintenance expense of producing an additional increment of output, including the variable fuel cost of production. It expressly does not include sunk capital costs that exist independently from the level of output. Nor does it include future costs that cannot be avoided by curtailing output. It also does not include other balance sheet costs such as regulatory assets.

Setting aside the extreme case of bankruptcy (which may increase short run marginal costs), the short run marginal costs of Pennsylvania utilities will not be affected by the level of stranded cost recovery (provided only that stranded cost recovery is not conditioned on continuing to operate all facilities irrespective of whether it is economic to do so). It follows that market prices for delivered bulk power in Pennsylvania will not be affected by stranded cost recovery. Neither competition, nor competitors will be injured.

Curiously, Mr. Brehm in a different context acknowledges that sunk costs have nothing to do with market prices. He uses the example of three firms with equal capability to produce output, one of which has a book cost of $2 billion, one a cost of $1 billion and one a cost of $0.5 billion. Each has the same market value because all would face the same prices for their output. Clearly, if the level of sunk cost does not affect prices, it follows also that the recovery of some portion of it outside of the generation market also will not affect prices.

Appendix C

Q. Mr. Brehm argues that in the past utilities may have kept open plant that should have been closed and asserts that PECO may be planning to keep open generating facilities that should be closed or at least not life extended. Isn't it the case that keeping open uneconomic facilities can depress prices, injuring competitors?

A. In principle, yes. However, this also has nothing to do with stranded cost recovery. If in the past it was necessary to continue to operate uneconomic facilities in order to keep them in rate base, there would have been an incentive to operate them when the value to shareholders of keeping them in rate base exceeded any costs they bore from uneconomic operation. However, my understanding of the situation in Pennsylvania is that stranded cost recovery is not contingent on the continued operation of the facilities with which it is associated if those facilities are rendered uneconomic by virtue of the transition to competition. A Pennsylvania utility will have no incentive to keep open those facilities that do not earn enough in the marketplace to cover their avoidable costs. In this context, avoidable costs include any fixed O&M and capital expenditures that would be required to keep them open. Hence, stranded cost recovery will not create any incentive to keep open generating stations that economically should be closed.

Q. Mr. Brehm specifically objects also to stranded cost recovery that reduces PECO's remaining costs of generation to below LRMC. Are there any competitive implications from basing stranded cost quantification and recovery on price levels below LRMC?

Appendix C

A. No. At a latter point in my testimony I will discuss Mr. Brehm and Mr. Falkenberg's assumption that market prices should equal LRMC. However, I will deal here with the narrower question of whether basing stranded cost recovery on forecasts of market prices below LRMC does harm to competitors.

Mr. Mendl makes a related point, asserting that if PECO is allowed excessive stranded cost recovery it either will earn excess profits (in effect, recover the same costs from the market and from stranded cost recovery provisions) or will injure competitors by selling at below market prices. Both Mr. Brehm's and Mr. Mendl's competitive concerns are mis-placed. If, hypothetically, PECO is granted a too high stranded cost recovery (and it is able to recoup the allowed stranded cost under its price cap), shareholders will have benefited. However, this will not harm competitors. It will not be in PECO's interest to sell at below market prices irrespective of whether it recovers all, more than, or less than its stranded costs. PECO's interest will be in maximizing returns to shareholders and, as is the case with competitive firms generally, this is not accomplished by giving away its output at below market prices. This is true whether the market price turns out to be above or below LRMC.

This actually is simply common sense. Suppose that the City of Boston decides that it is in its interest to build a football stadium in order to retain its NFL team. Does this mean that ticket prices will be less than they would be if the team had paid for the stadium itself? Presumably not, since it will set ticket prices at the profit maximizing price. An even better analogy would be if a steel company

acquired a facility at what turned out to be a below market price. Would it sell steel any cheaper as a result? No, it would sell steel at the market price and simply be more profitable because its book costs were lower.

The sole exception to this common sense rule has to do with predation. If PECO is "enriched" by stranded cost recovery (or less impoverished by some amount of stranded cost recovery), it arguably will be better able to bear the profit loss caused by its predatory pricing than if it had less deep pockets. However, the economic case for predation is very limited. In order to profitably engage in predatory pricing it is necessary to be able to drive competitors out of the market and keep them from returning. Assume, hypothetically, that PECO chose to drive down the price of power in Pennsylvania below the competitive level. PECO itself would lose money that it could have made at the competitive price. IPL (and other out-of-state utilities) might indeed choose to sell their output elsewhere. New generators might decide not to build plants for the Pennsylvania market. However, as soon as PECO began trying to sell power at above the competitive price (as it would have to be able to do if it was to recover the profits lost by starting the price war), IPL would turn around and sell into Pennsylvania, entrants would seek to build to serve this high priced market, and the forces of supply and demand quickly would drive prices back down to the competitive level. In my opinion, it is highly unlikely that predatory pricing will be profitable in US electricity markets for any firm.

* * *

APPENDIX D — EXCERPT OF TESTIMONY OF JOHN R. BREHM, SENIOR VICE PRESIDENT — FINANCE AND INFORMATION SERVICES, INDIANAPOLIS POWER & LIGHT COMPANY, BEFORE THE PENNSYLVANIA PUBLIC UTILITY COMMISSION

APPLICATION OF PECO ENERGY COMPANY FOR ISSUANCE OF A QUALIFIED RATE ORDER UNDER SECTIONS 2808 AND 2812 OF THE PUBLIC UTILITY CODE

* * *

Q26. Doesn't IPL oppose all stranded cost recovery?

(a) IPL does not oppose stranded cost recovery per se; however, we believe stranded cost recovery should not be based on the departure of a utility's outstanding securities' value from its book accounting cost but rather from the departure from the actual true current value of its assets which is best represented by replacement costs.

* * *

Supreme Court, U.S.
FILED
FEB 8 1999
CLERK

No. 98-1065

IN THE
Supreme Court of the United States
OCTOBER TERM, 1998

INDIANAPOLIS POWER & LIGHT COMPANY,
Petitioner,

v.

PENNSYLVANIA PUBLIC UTILITY COMMISSION
and PECO ENERGY COMPANY, *et al.*,
Respondents.

On Petition for Writ of Certiorari to the Commonwealth Court of Pennsylvania

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BRIEF IN OPPOSITION OF RESPONDENT PENNSYLVANIA PUBLIC UTILITY COMMISSION

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QUESTION PRESENTED

Whether it was a violation of the Commerce Clause of the U.S. Constitution for the Pennsylvania Public Utility Commission to allow an electric utility to recover costs associated with the transition to a competitive market for retail sales of electricity when these expenditures had previously been found to have been prudently incurred and recovery of those costs was placed on all customers regardless of whether they purchased electricity from that utility, other Pennsylvania utilities, or other electric generators located within and without the Commonwealth.

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On Petition for Writ of Certiorari to the Commonwealth Court of Pennsylvania

---

BRIEF IN OPPOSITION OF RESPONDENT PENNSYLVANIA PUBLIC UTILITY COMMISSION

STATEMENT OF THE CASE

Respondent Pennsylvania Public Utility Commission accepts the Statement of the Case as set forth by Respondent PECO Energy Company in its brief in opposition.

SUMMARY OF ARGUMENT

In bringing this request for a writ of *certiorari*, IPL seeks to re-litigate issues which it lost before the Pennsylvania Public Utility Commission, Commonwealth Court

and the Pennylvania Supreme Court. IPL Offers no reason which would meet the test established by Supreme Court Rule No. 10 and compel this Court to give it another bite at the apple.

It does this by disregarding the nature of the Customer Choice Act and its recognition of the costs of making the transition from a fully regulated environment to one in which the sale of electricity within Pennsylvania will be made in a competitive market. State regulated electric utilities will continue to provide regulated monopoly distribution and transmission services; however, they will now have to compete with each other, as well as with independent generators both inside and outside the Commonwealth when making sales of electric power. Thus, all Pennsylvania consumers will have the ability to choose their supplier of electricity.

However, in 1996, when the General Assembly passed and the Governor signed Pennsylvania's Electricity Generation Customer Choice and Competition Act, the provision of electric service by investor-owned utilities was still fully regulated. As such, these utilities had made prudent investments in facilities to serve the present and future needs of their customers under the obligations imposed by both state and federal law. Not all of the costs of these investments could be recovered in a competitive market. As a recognition of these expenditures made for the benefit of utility customers, the Customer Choice Act allowed electric utilities to recover these expenses over a temporary period of time and after reasonable mitigation measures have been taken.

IPL incorrectly calls this a "subsidy" and claims it violates the Commerce Clause of the Constitution. It is by no means a subsidy and it does not discriminate against interstate commerce. Moreover, the Pennsylvania Commonwealth Court recognized that the transition cost recovery provisions of the Act comport with, and in most respects mirror, current federal regulatory practice as well

as that of other states which are making the transition to an open market.

Collection of these costs poses no burden on interstate commerce and is not discriminatory. The Court should deny the request for a writ of *certiorari.*

REASONS FOR DENYING THE WRIT

I. INTRODUCTION

Indianapolis Power and Light Company (IPL), an electric utility licensed by the State of Indiana to serve customers in the Indianapolis area, challenged Pennsylvania's Electricity Generation Customer Choice and Competition Act [1] by claiming that allowing a utility to recover the prudently incurred costs of its transition from a regulated to a competitive market violates the Commerce Clause of the U.S. Constitution.[2] Commonwealth Court rejected IPL's arguments, holding correctly that the Customer Choice Act, specifically the provisions which allow a utility to recover its costs of transition from regulation to competition, do not discriminate against interstate commerce. *Indianapolis Power & Light Co. v. Pennsylvania Public Utility Commission,* 711 A.2d 1071 (Pa. Commonwealth Ct. May 7, 1998); Pet. App. 1a-38a. Instead of impeding commerce, the court held that the transition, or stranded, cost recovery provisions of the Act were an integral part of opening the market for electricity to competition in the Commonwealth. Moreover, IPL was unable to convince the Pennsylvania Supreme Court to review that decision. Pet. App. 145a.

The unanimous *en banc* decision of the Pennsylvania Commonwealth Court which IPL now seeks to bring before this Honorable Court for further review, addressed

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[1] 1996, Dec. 3, P.L. 802, No. 138, § 4 effective Jan. 1, 1997; codified at 66 Pa. C.S. §§ 2801-2812; Pet. App. 146a-231a, (Customer Choice Act or Act).

[2] U.S. Const., Art. III.

and rejected each of the arguments IPL proffered in support of its legal theory that recovery of transition costs would violate the Commerce Clause. The decision of Commonwealth Court affirms Pennsylvania's Customer Choice Act as being in harmony with regulation in virtually all states which are in the process of introducing competition in the sale of electricity as a means of lowering the cost of energy to consumers. Commonwealth Court correctly recognized that the Customer Choice Act was a lawful exercise of the state's authority to regulate the sale of electricity and not, in any way, in conflict with the Constitution, federal laws or the decisions of this or other courts.

II. THE HOLDING OF COMMONWEALTH COURT AFFIRMING THE LAWFULNESS OF THE CUSTOMER CHOICE ACT IS IN HARMONY WITH DECISIONS OF OTHER COURTS

IPL has challenged the PUC's order granting approval, in part, for PECO Energy to issue transition bonds pursuant to section 2812 of the Act, claiming that the PUC's order, and the Commonwealth Court decision affirming that order, violate the Commerce Clause of the U.S. Constitution in that it places out-of-state competitors of Pennsylvania utilities at a competitive disadvantage in competing for customers, thus creating an impermissible burden on intertate commerce.

As the court held, the Customer Choice Act in no way violates the Commerce Clause of the Constitution by acting as a means of protecting Pennsylvania utilities. To the contrary, the Customer Choice Act opened the provision of electric energy to retail purchasers of electricity to competition from Pennsylvania and non-Pennsylvania generators. Moreover the Act's provisions, that allow utilities to recover prudently incurred transition costs, which would otherwise be lost to the utility through the introduction of competiiton into retail sales of electricity are a necessary element of making the transition to a com-

petitive market. These costs are recovered from all customers regardless of who supplies them with electricity. The necessity for and manner of recovery comports with practices being adopted in other states, as well as those of the federal government as expressed through the orders of the Federal Energy Regulatory Commission (FERC), and as affirmed by the U.S. Court of Appeals.

A. The Pennsylvania Customer Choice Act

The introduction of competition into the retail sale of electricity had not been feasible in the past in part due to statutory barriers to the transmission of power contained in the Federal Power Act.[3] This effectively prevented anyone, with few exceptions, from selling power into the system of a local electric utility. However, the Energy Policy Act of 1992[4] amended the FPA making it easier for FERC, which regulates the wholesale market for electric power, to order one utility to transmit, or "wheel," power into or across its system on behalf of another party. As described below, FERC has issued regulations which require electric utilities to separate, or "unbundle," the sale of electricity from the transmission of power in wholesale transactions. Thus, the utility must sell the transmission of electricity and the electricity itself as separate services. This makes it possible for a generator, marketer or other seller of electric power to produce that power in one place and move it across one or more electric systems before selling the electricity to another utility.

The seller may also sell directly to an end-use customer in a utility's service area if that utility is open access and provides distribution only service. In short, the utility allows a customer to buy power from another source and the utility charges the customer for transmitting the power to its point of use. By and large, this is only possible in a

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[3] Federal Power Act, 16 U.S.C. § 791a *et seq.* (FPA).

[4] Energy Policy Act of 1992, Pub. L. 102-486, 106 Stat. 2776.

state which has adopted some form of open access for electric utilities.

Pennsylvania did that with the Customer Choice Act which was enacted by the General Assembly and signed by Governor Tom Ridge late in 1996. It became effective January 1, 1997. The legislation grew out of a PUC report made earlier in 1996 to the Governor.[5] The Competition Report was the culmination of a two-year study of the potential benefits and detriments which might be realized through the introduction of competition in the retail market for electricity which was then fully regulated by the Commonwealth through the Public Utility Commission.

In the Competition Report, the Commission found that, on average, rates for electricity in Pennsylvania were among the highest in the nation. Competition Report, p. 5; PECO Energy App. 1a-3a. Additionally, there were disparities among rate levels in different parts of the Commonwealth. *Id.* Perhaps more importantly, the PUC found that the marginal cost of electricity was considerably lower than existing retail rates, due primarily to "reduced capital cost, improved production efficiencies, and favorable oil and gas prices." *Id.* When these factors are combined with changes in federal energy policy such as the enactment of the Energy Policy Act of 1992, more lower-cost generation became available than had hitherto been the case.

In order to make this less expensive generation available to customers within the Commonwealth, the PUC recommended that retail customers be allowed to purchase electricity from generation suppliers other than their

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[5] *Investigation Into Retail Competition*, Docket No. I-940032, Report and Recommendation to the Governor and General Assembly on Electric Competition, July 1996 (Competition Report). Pertinent parts are reproduced in the Appendix of PECO Energy; PECO Energy App. 1a-20a.

native utility. In short, the Commission found that the industry should be restructured to permit competition among electric generators. It proposed a plan for implementation of competition which would be phased-in over a period of years. However, the PUC recognized that such a dramatic change in the industry would also lead to potentially serious problems.

One of the foremost of these was that of stranded costs. The PUC noted that:

> If consumer prices are to be based on market prices instead of regulated rates, market prices may not be sufficient to recover all existing utility investments and expenses. In general terms, costs currently included in rates which exceed the market value of the related asset are uneconomic. Upon the transition from regulated rates to market-based prices, uneconomic costs may become stranded to the extent that they are not recovered by market prices. These costs are in the regulated rates that consumers pay today, although they are not explicitly identified as stranded costs.

Id. at PECO Energy App. 3a.

The Commission found that the existing utility cost structure contained four categories of costs, which could become stranded. These were (1) regulatory assets such as deferred taxes and post-retirement employee benefits, (2) non-utility generation contracts, including contracts to purchase electricity from qualifying facilities pursuant to the Public Utility Regulatory Policies Act of 1978 [6] which required electric utilities to purchase power from certain types of independent generators, (3) utility generation assets, and (4) nuclear decommissioning costs. *Id.* at PECO Energy App. 3a-4a.

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[6] Public Utility Regulatory Policies Act of 1978, Pub. L. 95-617, 92 Stat. 3117.

The PUC recommended that the General Assembly include authority in any restructuring legislation which would allow the Commission to approve recovery of utility net stranded costs provided that the utility had followed a rigorous program of mitigating those costs. It found that, although it was not required to guarantee recovery of 100 percent of all stranded costs, fairness dictated that utilities were entitled to a reasonable opportunity to recover their net stranded costs. *Id.* at PECO Energy App. 18a-20a.

The Customer Choice Act, approved by the General Assembly later that year, did contain such provisions. The legislature found that:

> In establishing the standards for the transition to and creation of a competitive electric market, heretofore, public utilities generally have had an obigation to serve customers within their defined service territories; consistent with that obligation, have undertaken long-term investments in generation, transmission and distribution facilities in order to meet the needs of their customers, and have entered into long-term supply power supply agreements as required by federal law. In many instances these investments and agreements have created costs which may not be recoverable in a competitive market. The Commission is empowered under this chapter to determine the level of transition or stranded costs for each electric utility and to provide a mechanism, the competitive transition charge, for recovery of an appropriate amount of such in accordance with the standards established in this chapter.[7]

66 Pa. C.S. § 2802(15); Pet. App. 150a.

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[7] "TRANSITION OR STRANDED COSTS." An electric utility's known and measurable net electric generation-related costs, determined on a net present value basis over the life of the asset or liability as part of its restructuring plan, which traditionally would be recoverable under a regulated environment but which may not be recoverable in a competitive electric generation market and which the commission determines will remain following mitigation by the electric utility. 66 Pa. C.S. § 2803. Pet. App. 156a.

The Customer Choice Act also included a provision whereby utilities could further mitigate stranded or transition costs by obtaining a "qualified rate order" from the Commission pursuant to 66 Pa. C.S. § 2812; Pet. App. 213a-31a, which would allow the utility to sell, assign or otherwise transfer intangible transition property. This enables a utility to issue a transition bond which, in effect, securitizes the asset. Because of lower interest rates today than when these assets were created and other factors, transition bonds can reduce a utility's overall rates. The Commission order below is a qualified rate order; however, IPL's challenge was directed at the recovery of transition or stranded costs and not specifically at QROs.

B. Recovery of Stranded Costs in Other Jurisdictions

Pennsylvania is by no means the only jurisdiction that allows recovery of stranded costs as part of the transition to a competitive market for energy. In 1992 FERC issued Order No. 636 [8] which required interstate natural gas pipelines to unbundle their sales, storage and transportation services. Prior to that time local gas utilities and other pipeline customers had been able to purchase natural gas directly from pipelines as a bundled service. The pipeline would acquire gas from its own production facilities or buy it from producers in the production fields and use its pipeline to transport that gas to the customer, using storage facilities, if necessary.

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[8] Order No. 636, *Pipeline Service Obligations and Revisions to Regulations Governing Self-Implementing Transportation; and Regulation of Natural Gas Pipelines After Wellhead Decontrol*, Fed. Energy Reg. Comm'n Stats. & Regs. [Regs. Preambles 1991-1996] (CCH) ¶ 30,939, *order on reh'g*, Order No. 636-A, Fed. Energy Reg. Comm'n Stats. & Regs. [Regs. Preambles 1991-1996] (CCH) ¶ 30,950, *order on reh'g*, Order No. 636-B, 61 F.E.R.C. ¶ P61,272 (1992), *reh'g denied*, 62 F.E.R.C. ¶ 61,007 (1993), *aff'd in part and remanded in part, United Distribution Companies v. FERC*, 88 F.3d 1105 (D.C. Cir. 1996), *cert. denied*, 137 L.Ed.2d 845, 117 S. Ct. 1723 (1997).

Through Order No. 636, FERC directed that in the future all three services would have to be separately tariffed. It is also notable that FERC did not require pipelines to abandon their merchant services, although most have done so, leaving that task to marketing affiliates. FERC did see the necessity for allowing recovery of stranded costs and did permit pipelines *full* recovery. This action was upheld by the U.S. Court of Appeals for the District of Columbia Circuit on appeal. *United Distribution Companies v. FERC,* 88 F.3d 1105 (D.C. Cir. 1996), *cert denied,* 117 S. Ct. 1723 (1997). Many of the petitioners challenging Order No. 636 were natural gas producers or marketers independent of the pipelines. Although it may not have been in their individual self interest to do so, they recognized the necessity of allowing recovery of legitimate pipeline expenditures which could not be recovered in a competitive market. Moreover, this Court has recognized the applicability of decisions under the Natural Gas Act [9] to legal questions regarding the administration of the Federal Power Act and *vice versa.*

> Montana-Dakota Utilities was a case under the Federal Power Act rather than under the Natural Gas Act, but as we have previously said, the relevant provisions of the two statutes "are in all material respects substantially identical." *FPC v. Sierra Pacific Power Co.,* 350 U.S. 348, 353 (1956). In this opinion we therefore follow our established practice of citing interchangeably decisions interpreting the pertinent sections of the two statutes. See, e.g., ibid.; *Permian Basin Area Rate Cases,* 390 U.S. 747, 820-821 (1968).

Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571, 577 n.7, 101 S. Ct. 2925, 2930 n.7 (1981).[10] Based on these

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[9] Natural Gas Act, 15 U.S.C. § 717 *et seq.* Order No. 636 was promulgated under the Natural Gas Act.

[10] It is possible that the constitutionality of stranded cost recovery could reach this court through appeals of Order No. 888. The

cases the Court should consider the question of stranded cost recovery at the federal level as settled.

This can be illustrated by the fact that, in directing electric utilities to similarly unbundle their electric sales and transmission services, FERC again recognized that providing recovery of stranded costs was an essential part of bringing competition to energy sales:

> We reaffirm our preliminary determination that the recovery of legitimate, prudent and verifiable stranded costs should be allowed. . . .
>
> [W]e do not believe that utilities that made large capital expenditures or long-term contractual commitments to buy power years ago should now be held responsible for failing to foresee the actions this Commission would take to alter the use or their transmission systems in response to the fundamental changes that are taking place in the industry.

Order No. 888,[11] mimeo at 452-53. More specifically

> Order 888 permits stranded cost recovery from customers who terminate their wholesale service where the costs are "legitimate, verifiable and prudent." To obtain such recovery, jurisdictional utilities must satisfy a "heavy burden" that they had a "reasonable expectation" of continuing to provide service to departing customers for some period beyond the termi-

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Pennsylvania Commission submits that, if the Court believes that it needs to address this issue, a federal regulatory proceeding with national implications is the better case to review.

[11] Promoting Wholesale Competition Through Open Access Non-Discriminatory Transmission Service by Public Utilites; Recovery of Stranded Costs by Public Utilities and Transmitting Utilities, Final Rule, Order No. 888, 61 Fed. Reg. 21,540 (1996), FERC Stats. & Regs. ¶ 31,036 (May 10, 1996) (Order No. 888); *clarified*, 76 FERC ¶ 61,009 *and* 76 FERC ¶ 61,347 (1996), *order on reh'g*, Order No. 888-A, 62 Fed. Reg. 12,274 (Mar. 14, 1997), III FERC Stats. & Regs. ¶ 31,048 (1997) (Order No. 888-A), *order on reh'g*, Order No. 888-B, 62 Fed. Reg. 64,688, 81 FERC ¶ 61,248 (1997), *order on reh'g*, Order No. 888-C, 82 FERC ¶ 61,046 (1998).

> nation date and must further show that the claimed stranded costs were directly and proximately caused by FERC's open-access directive. Stranded cots are measured as the difference between revenues received during the prior three years of service under the contract (or during the prior most recent year if contract rates have changed) and the estimated market value of the capacity and energy involved. The latter may be estimated on the basis of pricing studies, a brokered sale by the customer of its former supply or by employing the customer's new power supply as a proxy for this value. The cost may be recovered either through an exit fee or by means of a surcharge imposed on future transmission service provided to the customer.

Hall, *Securitization and Stranded Cost Recovery,* 18 Energy L.J. 363, 367 (1997); footnotes omitted. FERC has reaffirmed its determination to allow recovery of stranded costs in subsequent orders.[12]

FERC has also encouraged the states to address this matter as they considered unbundling at the retail level:

> [T]he states have a number of mechanisms for addressing stranded costs caused by retail wheeling, one of which is a surcharge to state-jurisdictional rates for local distribution. We encourage the states to use the mechanisms available to them to address stranded costs.

Order No. 888, mimeo at 541.

Nor is Pennsylvania the only state which provides for the recovery of stranded costs as part of the introduction of competition for retail electric services. In total, 13 states, including Pennsylvania, California, Illinois and Michigan, now have legislation which provides for the

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12 Order No. 888-A, III FERC Stats. & Regs., *id.* at 30,348, 30,353-58.

restructuring of the electric industry to some degree.[13] At least eight others, including Texas and New York, have initiated programs sponsored by the respective state regulatory commissions or, in some cases, by utilities themselves. *Id.* In adopting legislation opening the retail sale of electricity to competition, the California legislature also found that recovery of stranded costs was a necessary condition to implementing competition.[14] Cal. Public Utilities Code § 330(s) (1996).

Many of these states also allow the use of securitized assets to reduce the impact of stranded cost recovery.

> Currently, California, Pennsylvania, Montana, Illinois, Massachusetts, Rhode Island, and Connecticut have adopted legislation that allows utiities to use this option and other states are considering it. In December 1997, three investor-owned utilities in California issued a total of $6.1 billion in securitized bonds (these companies have been authorized by the California Public Utilities Commission to issue up to $7.3 billion).

Kenneth Rose, *Brief Overview Of Securitization,* the National Regulatory Research Institute, the Ohio State University; PECO Energy App. 21a-24a.

Thus, Pennsylvania is in the mainstream of modern practice with respect to regulation of the electric indus-

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[13] *1998 Annual Report*, Section of Public Utility, Communications and Transportation Law, American Bar Association, pp. 189-96; National Regulatory Research Institute, Survey on Electric Industry Restructuring, Electric Industry Restructuring Box Score, www.nrri.ohio-state.edu. The NRRI is the research arm of the National Association of Regulatory Utility Commissioners.

[14] The California legislation contains provisions for the issuance of "Rate Reduction Bonds," similar to Pennsylvania's QROs. Cal. Public Utilities Code §§ 840-44.

try.[15] The Customer Choice Act can hardly be said to conflict with federal regulations or the laws of a growing number of states that have decided to introduce competition into utility regulation.

Commonwealth Court recognized this when it said:

> We are also convinced that the implementation of stranded-cost recovery mechanisms in other forums is compelling evidence that the Commerce Clause should not be used to hinder Pennsylvania's experiment with competitive electric generation. The move toward competitive utility markets is a national trend, and the recovery of stranded-costs is by no means isolated to the Competition Act. Those regulatory bodies, both federal and local, whose expertise has been relied on to facilitate the move toward open markets, seem to agree that the need for these recoveries is essential. As such, we are compelled to defer to PUC's decision to model Pennsylvania's move toward competition after these other forums, and we see no justification for implicating the Commerce Clause in derailing this ambitious endeavor.

IPL v. PUC, Pet. App. 22a-23a; footnote omitted.

In arguing that the Customer Choice Act violates the commerce clause, IPL ignores some important factual distinctions between the Pennsylvania Act and the Massachusetts law which is at the heart of its argument—*West Lynn Creamery, Inc. v. Healy,* 512 U.S. 186 (1994). *West Lynn Creamery,* cited throughout IPL's Petition, involves a very different industry. In that case, this Court struck down a Massachusetts Department of Food and Agriculture pricing order which created a "premium" on the price of milk sold in that state. *West Lynn Creamery,* 512 U.S. at 188-91.

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[15] For example, a Michigan court recently upheld the decision of that state's regulatory commission to introduce an electric competition pilot program. *Detroit Edison Co. et al. v. Michigan Public Service Commission,* 227 Mich. App. 442, 1998 Mich. App. LEXIS 15 (1998).

The Massachusetts premium involved an attempt to protect local industries by providing premiums above market prices. These premiums had no relation to *past* investment made by a state-licensed public utility in a fully regulated environment. The pricing order created a formula for the fixing of the premium which was to be assessed on a per unit basis on all producers selling milk in Massachusetts. *Id.* This included out-of-state as well as local producers. The revenues collected were placed into a fund from which payments were made to Massachusetts producers. This Court held that the arrangement gave Massachusetts producers of milk an advantage over out-of-state producers which created an impermissible burden on interstate commerce. *Id.* at 194.

IPL ignores the central distinction between the *West Lynn Creamery* pricing order and Pennsylvania Customer Choice Act. The allowance of recovery of stranded costs in no way amounts to, or compares with, the payment of artificially created premiums. Electric utilities in Pennsylvania made investments concomitant to their responsibilities to provide electricity on a safe and reliable basis to customers within their service territories under the state's long-standing regulatory regime. They have also had to enter into contracts to purchase electric power pursuant to government direction under the Public Utility Regulatory Policies Act of 1978 from independent power producers.

The stranded, or transition, costs an electric company recovers from its customers represent the return of the utility of its investment which, as a result of the change to a competitive market, it can no longer recoup. These costs are not subsidies, but rather recoupment of amounts the utility prudently spent on behalf of its customers. Amounts which, for the most part, have already been approved in prior PUC rate case orders. The investments now being recovered in Pennsylvania and other states were made due to obligations imposed by state and federal

laws and regulations. Moreover, the recovery of this investment is limited to a specified period of time and is not a permanent feature. *See* 66 Pa. C.S. § 2804(4)(i)(B)(ii), Pet. App. 162a.

Thus, recovery of stranded investment is a cost of making the transition to an open market for the sale of electricity and does not represent an impediment to interstate commerce. It is, in fact, an integral part of the creation of a market which heretofore did not exist. As the Pennsylvania Commonwealth Court correctly observed:

> Severing these [stranded cost recovery] provisions is in our minds implausible since they were regarded as so essential to the transition toward competition envisioned by the General Assembly and are so interwoven with the local utilities' continuing obligation to maintain transmission and distribution networks.

IPL v. PUC, Pet. App. 36a.

C. The Customer Choice Act Does Not Trigger the Dormant Commerce Clause

If a state law reaches out to the extent that it touches interstate commerce, it potentially triggers the *dormant* Commerce Clause. The dormant aspect of the Commerce Clause prevents actions by states to protect local economies by burdening out-of-state competitors. *New England Co. of Indiana v. Limbach*, 486 U.S. 269, 273 (1988).

> The Commerce Clause has a negative or dormant aspect which limits the power of the states to erect barriers against interstate trade *where Congress has not affirmatively acted* to either authorize or forbid the challenged state activity. . . . The dormant Commerce Clause doctrine serves to prevent a state from regulating business in such a way as to provide unfair advantage to its own residents at the expense of residents of another state.

Empire Sanitary Landfill v. Commonwealth, 546 Pa. 315, 332-33 (1966); (emphasis supplied). As noted above,

FERC, acting on the authority granted it by Congress through the Federal Power Act, has expressly encouraged the states to provide for recovery of stranded costs:

> We encouraged the states to use the mechanisms available to them to address stranded costs. . . .
>
> [T]he Commission intends to be respectful of state objectives so long as they do not balkanize interstate transmission of power or conflict with our interstate open access policie.

Order No. 888, p. 541-43.

Such an affirmative expression indicates the federal government's intention that the states should undertake programs to provide for the recovery of stranded costs as part of unbundled retail electric service. Given these and other determinations by FERC, Pennsylvania has federal imprimatur to provide for recovery of transition costs and, therefore, the dormant Commerce Clause is not triggered. Commonwealth Court, in a more detailed analysis came to the same conclusion:

> [T]he Competition Act, and the stranded-cost provisions contained therein, do not involve the Commerce Clause because they do not discriminate against interstate commerce. Allowing the act to remain as enacted by the General Assembly is consistent with Supreme Court precedent because the practical effect of the act is to promote competition. The stranded-cost provisions, which are an integral part of Pennsylvania's plan to open its electric markets to interstate competition, cannot be examined outside of the context of the entire act. The provisions limit stranded-cost recoveries both in terms of amounts and duration, and afford no unfair advantage to Pennsylvania utilities in the new electric generation market.

IPL v. PUC, Pet. App. 16a.

D. The Act Does Not Discriminate Against Interstate Commerce

Assuming that the commerce Clause would apply, there are two tests used in analyzing the impact of the state action on interstate commerce. The first is strict scrutiny review. This applies when a state or local law "facially" discriminates against out-of-state competitors and creates "local ecoonmic protectionism." *Empire Landfill* at 333; citing *C & A Carbone, Inc. v. Clarkstown,* 511 U.S. 383, 392 (1994). The Commission submits that the Customer Choice Act does not discriminate either facially or in actuality against out-of-state suppliers of electricity.

IPL argues that the provisions of the Act allowing for recovery of stranded costs discriminate in favor of "high cost" Pennsylvania utilities and against it as an out-of-state supplier of "low cost" electricity. IPL Pet. at 9. It states that such discrimination is in violation of the Commerce Clause in that it places a burden on out-of-state generators whose potential customers must subsidize Pennsylvania utilities. *Id.* IPL has wrongly misrepresented both the purpose and the effect of the transition cost recovery provisions of the Customer Choice Act.

First, not all Pennsylvania electric utilities are high cost generators, nor is it evident that all utilities will seek full recovery of stranded costs. Stranded costs are by definition, expenses and capital costs which, for the most part, are already in the rates being paid by Pennsylvania ratepayers. Through operation of a competitive transition charge the stranded costs allowed by the Commission will be recovered from and will apply to *all* customers in a utility's service territory. Thus, from the customer's perspective, it is neutral and will not affect a customer's choice of purchasing from either an in-state supplier or an out-of-state electricity supplier.

The stranded cost charge is intended to allow utilities to recover costs which they incurred in doing business in a *fully regulated* environment. Moreover, the underlying elements of these costs (generation plant investments,

deferred taxes, post-retirement employee benefits, nuclear decommissioning costs, etc.) have been previously determined by the Commission to be prudently incurred, reasonable in amount and, therefore, fully recoverable from customers under the prior monopoly regime. The Customer Choice Act does no more than establish a *temporary* mechanism by which these prudently incurred costs may be recovered, from all customers, during the transition to a fully competitive market for the sale of electricity. Thus, it creates an open market under the new regulatory paradigm that will allow all suppliers, including Pennsylvania utilities, to compete in an open market for generation.

IPL's argument that this amounts to plain discrimination has no support in the record to say the least. The Customer Choice Act caps electric rates for a period of time and requires utilities seeking to recover stranded costs to mitigate those costs. Moreover, *subsequent* to this case the Commission reviewed the utilities' restructuring plans including claims for recovery of stranded costs. These reviews included the restructuring plan of PECO Energy. Although IPL has filed an appeal of that proceeding, it is not part of the record below. Thus, IPL's claims with respect to the amount and nature of PECO Energy's stranded costs are merely speculative. Its arguments here are based on hypothetical assumptions regarding the nature and impact of stranded cost recovery on the market for electricity in the utility's service territory.

It is noteworthy, that the restructuring plan approved by the Pennsylvania Commission for PECO Energy resulted from a settlement among the utility and representatives of its residential, industrial and commercial customers, as well as marketers and generators of electric power both inside Pennsylvania and from out-of-state.[16]

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[16] *Application of PECO Energy Company for Approval of its Restructuring Plan Under Section 2806 of the Public Utility Code,*

As a result of this settlement, effective January 1, 1999, PECO Energy's customers are elegible to shop for electricity from a number of competing suppliers of electricity. IPL is not one of these competitors. It has never applied for a license to sell electricity in Pennsylvania.

Moreover, unlike the industries in the cases relied upon by the Petitioner, the electric industry is not fully deregulated in Pennsylvania. In Pennsylvania, the other states in the process of introducing competition and at the interstate level through FERC's orders, only the *sale* of electricity is being open to competitive forces. The distribution and transmission of electric power remain regulated monopoly functions.

IPL argues that the recovery of stranded costs is discriminatory because non-incumbent, non-Pennsylvania suppliers cannot recover their stranded costs. IPL has no stranded costs because its captive customers in Indiana who have no choice of generation supplier [17] are paying *all* of its embedded and marginal costs. Nor can it be argued that the mere difference between regulation in Pennsylvania and Indiana creates a burden on interstate commerce. The courts have upheld differences in regulation between states. When a gas distribution company which served both Pennsylvania and West Virginia and its affiliated pipeline brought suit against the PUC, it argued that the Commission had discriminated against interstate commerce by denying recovery of certain costs found to be imprudently incurred. *Kentucky West Virginia Gas Co., et al. v. Pennsylvania Public Utility Commission*, 837 F.2d 600 (3rd Cir. 1988), *cert. denied*, 488 U.S. 941 (1988). The regulatory commission in West Virginia had approved recovery of its jurisdictional share

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et al., PaPUC Docket Nos. R-00973953 and P-00971265, Final Order, 186 P.U.R.4th 105, (PaPUC May 14, 1998).

[17] Indiana has no customer choice law.

of the same costs. At issue was Act 74 [18] which enabled the PUC to disallow certain gas acquisition costs if they were incurred imprudently.

The court rejected the gas company's claim that this amounted to discrimination against interstate commerce:

> The commerce clause requires that states exercise their regulatory authority not in a manner exhibiting purely local favoritism in commercial concerns nor in a manner detrimental to the national concern of the free flow of gas in interstate commerce. Act 74 withstands commerce clause scrutiny under this standard because we find no evidence to indicate that it poses more than an incidental burden on interstate commerce and find instead that the Act complements the federal goal of consumer protection.

Kentucky West, 837 F.2d at 615. As noted above, if it does nothing else, the Customer Choice Act "complements" federal regulation of electricity through the introduction of competition to commodity sales. *See IPL v. PUC,* Pet. App. 27a-28a. ("The Competition Act, read in its entirety, is the antithesis of a statute that violates the Commerce Clause because it actually invites out-of-state competition in an area where states have been traditionally permitted to exclude such competition.") Given the absence of interference with interstate commerce, and the commonality of the Customer Choice Act with federal regulation and that of other states, there is no need to disturb the decision of the Commonwealth Court.

E. Strong Public Policy Reasons Exist to Support the Customer Choice Act

There are a number of powerful reasons which support recovery of stranded costs. The state has an absolute and compelling interest in seeing that the necessary funds are collected to ensure that utilities which own shares in

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[18] Pennsylvania Act of May 31, 1984, No. 1984-74, 66 Pa. C.S. §§ 1307(f), 1317-18.

nuclear generating stations will have adequate funds to decommission those plants when their useful life is finished. These costs are collected in rates over the life of the plant so that all ratepayers pay a fair share. It is vitally important that utilities be financially able to decommission plants containing dangerous radioactive material.

Additionally, under the Nuclear Waste Policy Act of 1982,[19] utilities pay a usage charge for each kilowatt hour generated to provide for the eventual storage of spent nuclear fuel by the federal government. Currently spent fuel is stored at each plant site. As with the decommissioning, a failure to remove this radioactive fuel is of the highest importance for the safety of Pennsylvania.[20] Additional concerns include the maintenance of reliable service for those consumers who do not shop for electricity as well as programs for low-income persons who cannot afford the full cost of electric service.

With respect to the other above market costs which could become stranded, the state has an interest in preserving the integrity of its electric distribution utilities. Given the magnitude of the stranded cost problem, it cannot be said that these companies will be able to continue to operate as financially viable concerns without some form of recovery. Indeed, numerous parties' presented evidence on this precise issue in the subsequent restructuring proceeding before the Pennsylvania Commission. Finally, as noted above, the state has an interest in assuming that obligations undertaken by utilities as a result of the Public Utility Regulatory Policies Act of

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[19] Nuclear Waste Policy Act of 1982, Pub. L. 97-425, 96 Stat. 2201, 42 U.S.C. §§ 10101-10226.

[20] *General Motors Corp. v. Tracy*, 519 U.S. 278, 304 (1997) ("First and most important, we must recognize an obligation to proceed cautiously lest we imperil the delivery by regulated LDCs [local natural gas distribution utilities] of bundled gas to the noncompetitive captive market.").

1978 are honored. Commonwealth Court recognized these concerns. *IPL v. PUC*, Pet. App. 30a-33a.

Finally, IPL argues that distribution utilities should be required to divest themselves of their generation assets. IPL Pet. p. 25-27. While such transactions could result from the restructuring process,[21] the Customer Choice Act does not require it. In fact, FERC does not reqiure it of utilities with respect to their wholesale sales of electricity. In addition, there was no evidence in the record of this proceeding that divestiture would promote interstate commerce.

The Commission submits that the public safety concerns set forth above tip the scales in favor of the constitutionality of the stranded recovery provisions in the Customer Choice Act.

CONCLUSION

WHEREFORE, the Pennsylvania Public Utility Commission requests the Honorable Court for an order denying the Petition for a Writ of *Certiorari* of Indianapolis Power and Light Company.

Respectfully submitted,

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[21] Some Pennsylvania utilities have voluntarily chosen to sell-off generation assets.

(4)

Supreme Court, U.S.
FILED
FEB 10 1999
CLERK

No. 98-1065

IN THE

Supreme Court of the United States

OCTOBER TERM, 1998

INDIANAPOLIS POWER & LIGHT COMPANY,

Petitioner,

vs.

PENNSYLVANIA PUBLIC UTILITY COMMISSION and PECO ENERGY COMPANY, *et al.*,

Respondents.

On Petition for Writ of Certiorari to the Commonwealth Court of Pennsylvania

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REASONS ON REPLY FOR GRANTING THE WRIT

The Commerce Clause issue framed by the Pennsylvania Act is straightforward. The Act opens the State's retail electric generation market to interstate competition, but requires all customers to pay a surcharge to subsidize incumbent, formerly monopoly Pennsylvania producers for uneconomic generation costs they cannot recover at competitive market prices. Respondents (including the Commission that prepared the Act) have said the purpose of this "stranded cost" subsidy is to "level the playing field" for in-state producers in competing with out-of-state producers. This Court's Commerce Clause precedents are equally clear. Discriminatory state regulation whose purpose or effect is to "enable higher cost [in-state producers] to compete with lower cost [producers] in other States" — thereby "neutralizing the advantage possessed by lower cost out-of-state producers" — is "clearly unconstitutional." *West Lynn Creamery, Inc. v. Healy*, 512 U.S. 186, 194 (1994).

PECO and the Commission resist *certiorari* with a flurry of assertions, all seeking to obscure the Act's obvious — and obviously discriminatory — purpose and effect. In a further effort to evade Commerce Clause scrutiny, PECO introduces novel "standing" theories that would automatically insulate the Act (or comparable discrimination by any State) from this Court's review. Respondents also ignore that parties *defending* such discrimination bear the burden of proving that the State has a legitimate objective that cannot be achieved by alternative, non-discriminatory means.

Respondents' arguments cannot conceal the core reality at the heart of this case. A State at the vanguard of a new field of interstate commerce, involving a vital product in universal demand, has purposefully chosen to discriminate in favor of its incumbent domestic producers. That choice is blessed in a reported appellate decision, which declares that State regulation of this developing interstate commercial arena lies in a "Commerce Clause free" zone. As the States launch their different regulatory experiments in a dawning era of interstate competition for retail electricity, this case poses a simple but critical question: Is discrimination favoring a State's own participants in that competition a constitutionally permissible ingredient in the experiment? Over 150 years of Commerce Clause jurisprudence leave no doubt this question merits an answer from this Court, and that the answer should be "no."

I. The Pennsylvania Act's "Stranded Cost" Provisions, Which Purposefully Subsidize Incumbent In-State Producers In Competition With Out-Of-State Producers, Unquestionably Discriminate Against Interstate Commerce.

Respondents' assorted pretenses that the Act does not discriminate against interstate commerce cannot be credited. The entities who receive "stranded cost" subsidies are incumbent, formerly monopoly producers located in Pennsylvania who generate electricity in that State. The purpose of the subsidies, as both respondents have repeatedly stated, is to "level the playing field" for such high-cost Pennsylvania producers in competition with lower-cost out-of-State producers.[1]

Respondents say the Act does not discriminate against interstate commerce because other, non-subsidized Pennsylvania suppliers are also handicapped. This is insupportable. This Court has roundly rejected any such thesis (even when, unlike here, the discrimination does not favor the largest in-state producers). *E.g., C & A Carbone, Inc. v. Town of Clarkstown*, 511 U.S. 383, 389, 391 (1994) (invalidating regulation favoring a single local company and handicapping all other in-state and out-of-state competitors); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 265, 272 (1984) (invalidating special tax exemption for only two of many locally produced alcoholic beverages). As this Court unanimously held in *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 276-77 (1988), "[v]arying the strength of the bar against economic protectionism according to the size and number of in-state and out-of-state firms affected would serve no purpose except the creation of new uncertainties in an already complex field."[2]

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1. *E.g.*, Definitive Form Brief for Respondent Commission at 15 (purpose of stranded cost provisions is to "level[ ] the playing field" so high-cost Pennsylvania generators "can compete in an open market for generation"); Commission's Brief in Opposition to Petition for Allowance of Appeal at 18 (same); Brief for Intervenor PECO Energy Company (Definitive Text) at 6 (stranded costs provisions "assure[ ] that there will be a 'level playing field' between the former monopoly utilities and all other potential generators, whether in-state or out-of-state"); *id.* at 8 (provisions "level[ ] the competitive playing field . . . [for] Pennsylvania electric utilities"); *id.* at 22 (provisions "create[ ] a level playing field for interstate competition"); *id.* at 25 (same); *id.* at 27 (same).

2. PECO's companion notion — that the Act does not discriminate against interstate commerce because stranded cost subsidies are not confined to former monopoly generators *incorporated* in Pennsylvania or *owned* by Pennsylvania shareholders (Br. 5) — is also insupportable. The discriminatory subsidies are patently (Cont'd)

PECO also suggests that existence of discrimination somehow turns on "fact" issues supposedly resolved against IPL below. *See* PECO Br. 12-13 & n.13 (saying "recovery of stranded costs does not . . . advance incumbent utilities' competitive position," and claiming "ample evidentiary support for PECO's contention" that "stranded cost proceeds" could not be used "for anticompetitive purposes.") This remarkable suggestion — from a party that repeatedly told the lower court the stranded cost provisions "level the playing field" for high-cost Pennsylvania producers — survives not an instant's scrutiny. To note the most obvious dispositive rejoinder, the Commission *did not find* that stranded cost recovery for PECO has no effect on competition. To the contrary, the Commission (which cited the same "level playing field" purpose) explicitly found that use of even a few days' interest income (or "float") on stranded cost proceeds would give PECO a competitive advantage. Pet. App. 111a.

PECO's "low entry barriers and low marginal pricing" contentions (Br. 13) would be of no Commerce Clause moment in any event. This Court has noted that even in the (unlikely) event a discriminatory state tax had no effect on out-of-state competitors' net revenues or costs, it would still cause "comparative economic injury" by "enab[ling] the favored [in-state competitors] alone to derive an increase in total revenue. . . ." *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, 496 U.S. 18, 48 & n.32 (1990).[3]

(Cont'd)
an attempt to induce generation of retail electricity within Pennsylvania, when that activity could more efficiently be performed elsewhere. This is a core Commerce Clause violation. *E.g., West Lynn Creamery*, 512 U.S. at 193-94; *Westinghouse Elec. Corp. v. Tully*, 466 U.S. 388, 406 (1984); *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318, 336 (1977). It is absurd to suggest, for example, that this Court's analysis in *West Lynn Creamery* — which struck down "premium" payments that discriminatorily subsidized Massachusetts milk producers — would have differed because a particular milk producer operating in Massachusetts may have been a New Hampshire corporation with Vermont shareholders.

3. As part of its conjuring on "factual findings," PECO also represents that the Commission

> considered and rejected the argument that PECO's recovery of stranded costs would *discriminate against other suppliers* and would *impose an impermissible burden on interstate commerce*, concluding that "[t]here is simply no factual basis upon which to make such a determination." Pet. App. 63a.

Br. 6 (emphasis added). Perusal of "Pet. App. 63a" shows the Commission made *no*
(Cont'd)

PECO also asserts there is no discrimination because it and out-of-state competitors are not "'substantially similar entities.'" Br. 13, quoting *General Motors Corp. v. Tracy*, 519 U.S. 278, 298 (1997). Not so. The "dissimilar" parties in *Tracy* were (1) regulated monopoly LDCs primarily serving captive residential customers, and (2) out-of-state suppliers whose limited competition with LDCs was confined to a separate market comprising business customers. *See* 519 U.S. at 297-302; Pet. 15-16. Here, PECO and out-of-state generators are *identically situated* as non-monopoly competitors in a single, open market for electricity generation for all retail customers, none of whom is legally "captive" to any generator.[4]

II. PECO's Meritless "Standing" Theories Are A Blueprint For Insulating Discriminatory Schemes Like Pennsylvania's From This Court's Review.

PECO's "standing" notions are notable primarily for "Catch 22" reasoning that would effectively immunize from this Court's review both the Act here and any discriminatory state scheme that follows the Pennsylvania model. PECO first asserts that IPL is not a party "injured" by Pennsylvania's discriminatory subsidies for its in-state generators. However, the Commission rejected PECO's standing challenge, ruling:

> [T]he Act requires this Commission to foster a competitive retail generation market. Therefore, any participant in this future market has a direct interest in the structure and rules of that market. As the owner of generation resources which it may sell

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(Cont'd)
finding on either italicized factor. Indeed, the Commerce Clause argument of the Environmentalists the Commission was addressing — an argument comprising two paragraphs and a footnote, RR. 224a-227a — did not even mention "discriminat[ion]" or "burden on interstate commerce." Even if the Commission had assayed a "factual finding" of "no discrimination," discrimination against interstate commerce is a *legal* issue determined primarily on the basis of the state law involved.

4. This is underscored by the fact that PECO's claims to be "dissimilar" (Br. 13) do not require subsidizing its uneconomic *generation* costs. *E.g.*, PECO's obligation to serve "low income" customers is underwritten by a *separate* surcharge elsewhere in the Act. Its "distribution and transmission services" are regulated monopoly functions (compensated by regulated monopoly rates), which entail no generation costs and are expressly "unbundled" from competitive generation of retail electricity. As to "provider of last resort" duties, the Act is explicit that the "provider" (1) need not be the *generator* (but may simply purchase and provide electricity generated by others), and (2) need not necessarily be the incumbent Pennsylvania utility. *See* Pet. 2, 27.

> in the Commonwealth, IP&L has a direct interest in this proceeding.

Pet. App. 45a. PECO then did not even contest standing in the state courts.

But PECO claims IPL has now lost standing, saying it "has not demonstrated an 'imminent' threat" of injury because it is not currently competing in the Pennsylvania retail generation market. Br. 20. Specifically, PECO asserts that (1) under the Act, retail "generation competition in Pennsylvania commenced on January 1, 1999" — *i.e., after* IPL's petition for *certiorari* was filed; (2) "IPL has not filed an application with the [Commission] to do business in Pennsylvania"; and (3) "more than 75 entities" have filed such applications, and "many" of them "began providing service" to Pennsylvania customers "on January 1, 1999." Br. 20 n.20. "[T]herefore," says PECO, it is "no answer for IPL to say that it is unwilling to commit resources to competing in Pennsylvania as long as the 'unfair' stranded [cost] rules are in place." *Id.*

On its own terms, this is a *non sequitur*. IPL does not somehow "lose" its standing to challenge the Commerce Clause violation based on the supposed willingness of other "entities" to proceed under unconstitutional conditions. Furthermore, PECO's extra-record assertions about "many" unidentified "entities" who entered the Pennsylvania retail electricity market some five weeks ago — and its implication about their "[willingness] to commit resources to competing in Pennsylvania [with] the 'unfair' stranded [cost] rules . . . in place" — wholly ignore the difference between electric generation *producers* and generation *resellers*. Competitors who directly or in effect merely purchase generation and resell it to retail customers under the Act — such as "brokers," "marketers" and "aggregators," 66 PA. CONS. STAT. § 2809(a), (f) (Pet. App. 192a, 196a) — are *not* directly affected by the discriminatory stranded cost subsidies for high-cost incumbent Pennsylvania generators. The unconstitutional discrimination, in both purpose and effect, is against low-cost, out-of-state generation *producers* like IPL.

The "injury" prong of PECO's standing thesis fails in any event under this Court's precedents, which require only a "sufficient likelihood of economic injury. . . ." *Clinton v. City of New York*, 118 S. Ct. 2091, 2100 (1998).

> The Court routinely recognizes probable economic injury resulting from [governmental actions] that alter competitive conditions as sufficient to satisfy the [Article III 'injury-in-fact'

> requirement] . . . . It follows logically that any . . . petitioner who is likely to suffer economic injury as a result of [governmental action] that changes market conditions satisfies this part of the standing test.

Id. (ellipses and brackets added by Court), quoting 3 K. DAVIS & R. PIERCE, ADMINISTRATIVE LAW TREATISE 13-14 (3d ed. 1994). As the Commission ruled, IPL satisfies that test here.[5]

PECO also says (Br. 20-21) that IPL "has not demonstrated an 'imminent' threat . . . that PECO would use stranded cost recovery 'to sell power well below PECO's cost.'" This is unintelligible. The whole point of the stranded cost provisions is to require Pennsylvania retail generation customers to pay PECO (and other in-state incumbents) a surcharge representing the difference between their (higher) generation costs and the (lower) competitive price for generation. Hence, in the competitive market PECO will by definition "sell power well below PECO's cost." Were that not so, there would be no consumer surcharge.

The underlying notion of PECO's "injury" thesis is that a party injured by a State's erecting a discriminatory barrier to entry into a newly created interstate market must, during the pendency of its challenge, proceed to enter that new market as a precondition to this Court's review of the very unconstitutional barrier that makes its entry pointless. The same "Catch 22" reasoning is all but explicit in the second prong of PECO's thesis, prompted by the Commonwealth Court's alternative holding that the Electric Generation Act is not severable — *i.e.*, that if the stranded cost provisions are unconstitutional, the entire Act must fall. Pet. App. 33a-36a. From this, PECO suggests (Br. 21) that IPL lacks standing because, if its challenge succeeds, there will be no competitive retail generation market in Pennsylvania for IPL (and all other potential competitors) to enter.

This is too cute by half. As this Court has repeatedly noted in Equal Protection Clause cases, an unconstitutional inequality often can be remedied by either extending a benefit to plaintiff or withdrawing it from others (or by either relieving plaintiff of a burden or imposing it on others). Notwithstanding

5. Like appellees in *Clinton*, IPL's "injury in this regard is [also] at least as concrete as the injury suffered by the respondents in *Bryant v. Yellen*, 447 U.S. 352 (1980)." 118 S. Ct. at 2100. *See id.* at 2100-01 (prospective land purchasers in *Bryant* had standing "'even though they could not with certainty establish that they would be able to purchase excess lands' if the [challenged] judgment were reversed, . . . because it was 'likely that excess lands would become available at less than market prices'") (quoting 447 U.S. at 367, 368).

that invalidation of the inequality therefore may not result in plaintiff's obtaining the benefit (or being relieved of the burden), the Court "has nonetheless consistently upheld plaintiffs' standing." R. FALLON, D. MELTZER & D. SHAPIRO, HART AND WECHSLER'S THE FEDERAL COURTS AND THE FEDERAL SYSTEM 150 (4th ed. 1996) ("HART & WECHSLER"), citing *inter alia Heckler v. Mathews*, 465 U.S. 728 (1984), and *Orr v. Orr*, 440 U.S. 268 (1979).[6]

Heckler is directly in point. There, Congress provided that if a statutory discrimination extending a benefit to some were invalidated, the entire benefit provision should fall — thus assuring that anyone challenging the discrimination could never obtain the benefit. This Court held the statutory non-severability provision (and result) could not divest a plaintiff's standing. 465 U.S. at 734-41. That decision "is surely sound; to have denied standing would have effectively immunized the statute from judicial review." HART & WECHSLER at 151. The state court below, *via* its non-severability holding, attempts the same immunization of Pennsylvania's discrimination against interstate commerce. *See* Pet. App. 33a-34a. The tactic deserves no more success here than in *Heckler*.

III. Respondents Bear The Burden Of Proving That The State Had No Alternative Means To Achieve Any "Interests" Purportedly Served By The Act's Discriminatory Stranded Cost Subsidies.

PECO argues (Br. 16-17) that IPL did not present sufficient "evidence" on the "divestiture alternative." The Commission (Br. 23) concurs. This supposed "fact" issue is a transparent attempt to change the law. This Court has held time and again that parties *defending* a discriminatory state law bear the burden of proving the State has no alternative means to achieve a legitimate (*i.e.*, non-protectionist) interest. *E.g., C & A Carbone*, 511 U.S. at 392; *Oregon Waste Sys., Inc. v. Department of Envtl. Quality*, 511 U.S. 93, 100-01 (1994); *New Energy Co.*, 486 U.S. at 278. Here, respondents wholly failed to carry that burden. Among other things, PECO presented no evidence to support its counter-intuitive argument (Br. 16-17) that divestiture would result in "less competition" in the competitive generation market.[7]

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6. Similarly, this Court has noted in the Commerce Clause context that an unconstitutionally discriminatory state tax may be remedied by either refunding plaintiff's tax payments or imposing the tax on the in-state competitors. *McKesson Corp.*, 496 U.S. at 39-41.

7. In representing to this Court the extent of "the record developed by IPL on the divestiture alternative" (Br. 17 n.17), PECO also overlooks the report of the New

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PECO also says IPL "apparently" challenges only "the *amount* of stranded cost recovery" — from which PECO tries to extract an inference that the stranded cost provisions necessarily do not "violate[ ] constitutional norms as a matter of law." Br. 15 (emphasis original). PECO's premise that IPL challenges only "amount" purportedly derives from IPL's acknowledgment that factors such as "nuclear decommissioning" are "valid local interests." Br. 14. This blatantly ignores IPL's actual (and dispositive) Commerce Clause arguments as to such state "interests." The first and most basic point remains that all such interests could be achieved by conditioning recovery of stranded generation costs on divestiture of the generation business — and certainly PECO, who has the burden of proof on the issue, did nothing to show otherwise. Pet. 24-26. As IPL also pointed out, the discriminatory stranded cost provisions could not in any event be justified by such state interests, because the subsidies given the incumbent Pennsylvania utilities are not limited to amounts necessary to achieve those interests (if any). Pet. 26-27.[8]

IV. Congress Has Neither Authorized The States To Impose Discriminatory Stranded Cost Schemes, Nor Given FERC Any Authority To Grant Such Supposed "Authorization."

Embellishing the state court's refrain that the Commerce Clause is "not involve[d]" (*e.g.*, Pet. App. 12a, 16a), the Commission reprises (Br. 17) its theory that, "[g]iven" various "determinations" by FERC in regulating at the wholesale level, "Pennsylvania has federal imprimatur to provide for recovery of [stranded] costs and, therefore, the dormant Commerce Clause is not triggered." This ignores that any "imprimatur" for state discrimination must come from *Congress*; that it must be "expressly stated," "unmistakably clear," and "unambiguous"; and that this Court has *twice* held that the Federal Power

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Hampshire Public Utilities Commission, introduced as an exhibit, which concluded *inter alia* that "government-mandated stranded cost recovery is inconsistent with effective competition," but "[t]his problem can be avoided by requiring that the assets be sold [*i.e.*, divested] prior to the introduction of competition so that the incumbent does not end up with both the cash and the paid-off asset." RR. 350a.

8. PECO's misleading premise that IPL challenges only the stranded cost "*amount*" also purports to be based (Br. 15) on a selective, out-of-context quotation of IPL witness testimony. That testimony, also reprinted selectively and out-of-context in PECO App. 30a, is not even in the Reproduced Record submitted to the court below. Further, the scarcely intelligible snippet PECO reprints in fact relates to both a definition and a treatment of "stranded costs" wholly different from the discriminatory Pennsylvania version at issue here.

Act does *not* authorize State regulation that would otherwise violate the dormant Commerce Clause. *See* Pet. 14-15 (citing cases).

The Commission's thesis also ignores that Congress has refuted any notion that FERC can stamp discriminatory state retail regulation with a "federal imprimatur." FERC authority to order wholesale "wheeling" — *i.e.*, requiring monopoly transmission and distribution facilities to be made available for competitors in the generation market — was conferred by the 1992 Energy Policy Act amendments to the Federal Power Act (pertinent provisions codified at 16 U.S.C. §§ 824j-824k). The Conference Report makes clear that FERC's authority as to wholesale competition has *no* effect on the validity *vel non* of State retail regulation:

> New section 212(h) of the Federal Power Act contains a *savings* clause for State laws dealing with retail wheeling. Thus, State laws that either prohibit or permit retail wheeling *are unaffect[ed]* by this subsection[, a]nd, *if otherwise valid*, remain in full force and effect.

H.R. CONF. REP. No. 102-1018 at 388, *reprinted in* 1992 U.S.C.C.A.N. 2472, 2479 (emphasis added). *See Sporhase v. Nebraska* ex rel. *Douglas*, 458 U.S. 941, 959-60 (1982) (even when federal statutes reflect "deference" to state law, "[t]he negative implications of the Commerce Clause . . . are ingredients of the *valid* state law to which Congress has deferred") (emphasis original).[9]

CONCLUSION

Respondents' chorus throughout is that since Pennsylvania is opening competition where none existed before, "fairness" demands that it be permitted to "compensate" its incumbent in-state producers for uneconomic costs allegedly attributable to their former status as regulated monopolists. But no non-protectionist "interest" in compensation requires conferring discriminatory subsidies on these in-state producers as competitors in an open interstate market. Divestiture fully achieves any compensation objective. Pennsylvania has no legitimate "state interest" to insist that formerly monopoly in-state generators must participate in a market it opens to interstate

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9. The Commission's discourse on federal law also includes the astounding suggestion (Br. 10-11 n.10) that "the constitutionality of stranded cost recovery could reach this court through appeals" of FERC regulatory action, and that "a federal regulatory proceeding with national implications is the better case to review." To state the obvious, federal regulation is not subject to the dormant Commerce Clause strictures that circumscribe State regulation.

competition, and then further insist that it may "level the playing field" *via* discrimination favoring these domestic participants.

This is so *regardless* of the regulatory or other economic history that supposedly disadvantages domestic competitors and persuades the State's political branches that the interstate playing field "needs" discriminatory leveling. Comparative advantages and disadvantages among competitors from different States never arise in a regulatory or economic vacuum. Cost differentials are always traceable to historical roots, whether planted by nature (*e.g.*, the relative scarcity or abundance of a valuable resource in a given State) or the law (*e.g.*, the impact of a State's environmental or, as in this case, past utility regulation). States have wide experimental latitude in responding to these realities; but discrimination favoring their domestic participants in competitive interstate markets is a beaker that must be left on the laboratory shelf. This is the central principle of this Court's dormant Commerce Clause jurisprudence.

Respondents urge abrogation of that principle, on the ground that the in-state participants' claimed disadvantage here arises from the State's own regulatory history. This "transition from monopoly" refrain is simply this case's version of the standard rationale always put forth to "justify" state discrimination — which is always predicated on particular factors peculiar to the economic context of the particular competitive interstate arena involved. Here, that familiar rationale — blessed by the state court as a legitimate "state interest" justifying discriminatory regulation of retail electricity generation — invites protectionist and retaliatory economic warfare among the States in a vital new field of interstate commerce.

The constitutional question is squarely framed. The answer is of national import. This Court should grant review.

Respectfully submitted,

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